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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1944.

No. 379

COLORADO INTERSTATE GAS COMPANY,
a Corporation, PETITIONER,

v.

FEDERAL POWER COMMISSION, CITY AND COUNTY OF DENVER, COLORADO, PUBLIC SERVICE COMMISSION OF WYOMING, COLORADO-WYOMING GAS COMPANY, PUBLIC SERVICE COMPANY OF COLORADO, and CANADIAN RIVER GAS COMPANY, RESPONDENTS.

BRIEF OF PETITIONER.

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TABLE OF AUTHORITIES.

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OPINION BELOW.

The opinion of the Circuit Court of Appeals, Tenth Circuit, is reported in 142 Fed. (2d) 943.

GROUNDS UPON WHICH JURISDICTION OF THIS COURT IS INVOKED.

The jurisdiction of this Court is invoked under Section 19 (b) of the Natural Gas Act (52 Stat. 821; Title 15, U. S. C. A., Sec. 717r) and Section 240a of the Judicial Code as amended by the Act of February 13, 1925 (Title 28, U. S. C. A., Sec. 347). A copy of the sections of the Natural Gas

Act pertinent to this review is attached hereto as Appendix A. Certiorari was granted on November 13, 1944.

STATEMENT OF THE CASE.

1. The Case for Review.

This is a rate case involving an order of the Federal Power Commission (hereinafter referred to as the "Commission") under the Natural Gas Act, reducing the rates charged by petitioner, Colorado Interstate Gas Company (hereinafter sometimes called "Colorado Interstate"). In the same case the Commission entered similar orders reducing rates of Canadian River Gas Company (hereinafter sometimes called "Canadian") and Colorado-Wyoming Gas Company (hereinafter sometimes called "Colorado-Wyoming"), petitioners in Cases Nos. 380 and 575, respectively. The Circuit Court of Appeals affirmed the Commission's order in all respects.

The Court in granting certiorari, limited its review to Questions 5 and 6 stated in the Company's petition. These are:

"5. Whether consistently with the requirements of the Fifth Amendment to the Constitution of the United States and the Natural Gas Act the Commission could determine reasonable rates for gas sold for resale in interstate commerce without making a separation or allocation of the property of Canadian and petitioner which, in this case, is used in making intrastate sales in Texas and interstate sale of both resale and direct sale gas, the Commission having no jurisdiction over intrastate sales or over direct sales in interstate commerce to industrial consumers.

"6. Whether the Commission's substitute method of allocation of cost of service which results in burdening non-regulable gas with costs actually chargeable against regulable gas violates the Fifth Amendment to the Constitution of the United States and the Natural Gas Act."

2. The Petitioner's Operations.

Canadian owns a natural gas producing property in the Panhandle Field in Texas. Of the gas produced by it, a part is sold in the producing field in intrastate commerce; a part is delivered in the field to the compressor stations of Texoma Natural Gas Company for eventual sale and delivery to the Natural Gas Pipeline Company of America, which extends to the Chicago area; and a part is transported through Canadian's pipe line, which extends 86 miles to a point near Clayton, New Mexico, where it connects with the pipe line of Colorado Interstate. Canadian sells gas from its pipe line to its intrastate customers in Texas, to the Clayton Gas Company in New Mexico and to Colorado Interstate at the point of connection of the two pipe lines.

Colorado Interstate transports such gas through its pipe line, which extends to Denver, and sells gas in part to various distributing companies in Colorado for resale by them. Gas is transported and sold near Denver to Colorado-Wyoming, which that company transports and sells at points in northern Colorado and at Cheyenne, Wyoming.

In addition to the gas so produced, gathered and transported for a distance by Canadian, and transported for a greater distance by Colorado Interstate, and sold by the last named company for resale, gas is also transported by means of the same facilities in part and sold directly to industrial customers in Colorado for their consumption. It is to be remembered that such direct sales to industrial customers, even though made in interstate commerce, are by the terms of the Natural Gas Act excluded from regulation. See Section 1 (b) of the Natural Gas Act contained in Appendix A hereto. A flow diagram map of the pipe line systems of Colorado Interstate, Canadian and Colorado-Wyoming showing the quantities of gas produced, gathered, transported and delivered to the several classes of customers, which was prepared and introduced by engineers of the Commission (R. V. 2, p. 1079), is hereto attached as Appendix B. From this flow diagram, and from the undisputed evidence more specifically referred to hereinafter, it is established that (1) gas transported solely in intrastate

commerce, and (2) gas transported in interstate commerce make common use of Canadian's pipe line. It is also established that of the gas transported by Canadian and Colorado Interstate in interstate commerce (1) gas sold directly to industrial customers and excluded from regulation by the terms of the Act, and (2) gas sold for resale and now subject to regulation, likewise make common use of the greater part of the two pipe lines. Such evidence also establishes that certain parts of Colorado Interstate's pipe line are used exclusively by one or the other classes of gas.

In its determination of rates to take the place of contract prices agreed upon prior to the Natural Gas Act, the Commission made no separation or allocation of the property used in common in the intrastate and interstate business, nor of that likewise used in common in the sale of the regulable and unregulable portions of gas in interstate commerce. It did not even separate out property used exclusively in intrastate commerce, nor that used exclusively by the unregulated business in interstate commerce. In lieu of such a separation and allocation of property, it employed what it termed an "allocation of cost," and, upon that basis, Canadian was ordered to reduce its charges for gas sold to Colorado Interstate by the amount of $551,000 annually, and Colorado Interstate was ordered to put into effect rates as of May 20, 1942, which would effect an annual reduction of $2,065,000. (R. V. 1, pp. 140-195, 295.)

Admitting that it had no jurisdiction over the rates charged by petitioner for gas sold directly to industries, nevertheless, the Commission used methods legally applicable only in cases where full rate regulatory jurisdiction exists. In so doing it failed to stay within the jurisdictional boundaries established by Congress. The Circuit Court of Appeals based its affirmance on the impact of the order "in its totality," and thus failed to recognize the jurisdictional importance of the method employed by the Commission. It is only in situations where complete jurisdiction exists that the principles announced in the cases of *Federal Power Commission v. Natural Gas Pipeline Company of America*, 315 U. S. 575, and *Federal Power Commission v. Hope Natural Gas Company*, 320 U. S. 591, can apply. The Commission

went beyond the ambit of its statutory authority and in order to demonstrate that fact it is necessary to present a detailed analysis of the method of allocation proposed by petitioner and the method followed by the Commission.

3. The Company's Evidence.

The jurisdictional requirements can be met only by determining the basic features affecting the property used and held available for use by the regulable gas. These are:

1. The property used exclusively for regulable gas and that used exclusively for unregulable gas.
2. The property used in common by regulable and unregulable gas, and an allocation thereof to the regulable gas of the portion used and held available for use by it, based upon:
   a. The priority rights to line capacity by regulable gas,
   b. The actual use of line capacity in the past by regulable gas and unregulable gas and the volume sold and peak loads experienced during such period, and
   c. The translation of this use into terms of net investment of the property so allocated to regulable gas.
3. The determination of all costs involved in operating the property so allocated to regulable gas and in selling such gas to the customers.

Upon all these points the petitioner presented evidence. The petitioner's witnesses not only separated the property according to its use, but assigned to the several parts the original cost and the present fair value thereof, and the operating expenses with respect thereto, which were summarized in appropriate operating or rate statements. (R. V. 5, pp. 2453-2494.) However, under the limited review now granted, we assume that the dollar amounts assigned to the several classes of property are not material. Only the evidence disclosing the method and principle of separation em-

ployed by the Company, and the failure of the Commission to make any separation at all is here dealt with.

Colorado Interstate's witnesses first separated out the property used exclusively in servicing or supplying the non-regulable gas and that used exclusively in the sale of regulable gas.

The evidence shows that certain lateral lines are used exclusively for delivering gas to customers for resale, and that certain other laterals are used only for delivering gas to direct sale customers. By reference to Appendix B, Commission's flow diagram map, it will be seen that the relatively extensive lateral line branching off from the main line south of Pueblo, Colorado, is used exclusively in the direct sales of gas to Colorado Fuel and Iron Corporation. Similarly, the laterals to the Colorado Portland Cement Company, American Crystal Sugar Company, Atchison, Topeka & Santa Fe Railroad Company, the United States Helium Plant and the Fort Lyon Hospital are all used exclusively in the unregulated business. Other laterals are used exclusively in the regulated business. Such lateral lines were by the petitioner's witnesses assigned to the two classes of business in accordance with their use. (R. V. 4, pp. 2265, 2271.)

Metering stations were likewise divided by the Company's witnesses on the basis of the exclusive use to which they were put. Since each class of business necessarily had its own meters, this separation of property was easily made. (R. V. 4, pp. 2265, 2276-2278.)

After separating the property used exclusively in the regulable or unregulable business, it was then necessary to separate that used in common by both classes of business. The main pipe line from its junction with the Canadian Company's line at Clayton Station, New Mexico, to a point just east of Pueblo, Colorado, a distance of approximately 200 miles, is so jointly used. The remainder of the pipe line from that point north to Denver, a distance of 105 miles, is almost, but not quite, entirely used by the resale or regulable gas, and thus has to be separated on a use basis. This separation necessarily had to take into consideration prior

right to the use of the line by the resale or regulated business over the unregulated business, evidence of which is now summarized:

Evidence as to Prior Right to the Use of the Line by the Regulated Over the Unregulated Business.

The allocation of property used in common by regulable and unregulable gas reflected the priority right to line capacity of gas sold for resale to domestic consumers over all other gas. This preference was a condition precedent to the whole project; was included in all of the contracts between petitioner and its customers; and has been observed in practice. Necessarily these rights are reflected in the actual peak loads and volumes used as data in the allocation of the commonly used property.

The original agreement of April 5, 1927, between the parties who financed and incorporated Colorado Interstate and those who established the Canadian Company contained a provision that the domestic customers (sales for resale to such customers being later subjected to regulation by the Natural Gas Act of June 21, 1938) should have preference and priority over industrial customers in case of shortage of gas for any reason. (R. V. 1, pp. 281-390.)* The carrying out of the project as provided in said original agreement was conditioned upon the acquiring by the distributing companies in Denver and Pueblo of franchises for the distribution of natural gas in lieu of manufactured gas which they were then serving. Such franchises were obtained. The Denver franchise contained this provision in Section 4:

"It is further determined that the rates to be charged by said Company for natural gas service to industrial users for heating, manufacturing and power purposes in the City and County of Denver for the term of said Fran-

*Included in the category of domestic customers are customers frequently classed as commercial, such as laundries, bakeries, restaurants and similar establishments: Gas sold to distributing companies and municipalities for resale to industrial customers, while subject to regulation, has no priority over industrial gas sold direct to consumers. The quantity of such gas sold is relatively small in comparison with direct industrial sales, and sales for resale to domestic and commercial customers. Appropriate treatment is given to this fact in petitioner's evidence.

chise may be lower and different from those charged for domestic purposes and the Company shall have the right to contract with industrial users for the sale of such natural gas, provided that all such contracts contain a 'cut-off' clause which recognizes the preferred right of the domestic users over the industrial users." (R. V. 1, pp. 338, 339.)

The Pueblo franchise in Section 8 contained substantially the same sort of provision, and in the contract between Colorado Interstate and the City of Colorado Springs, which owned and operated its own distribution system, such provisions were also contained.

Provision for such priority was included in all of the contracts of the petitioner with the distributing companies at Denver and Pueblo, and with the company distributing gas to La Junta and a few small villages in southeastern Colorado. (R. V. 2, p. 1024.)

All of petitioner's contracts with its industrial customers were negotiated on the basis of this priority to the resale customers, and of this provision for interruption to their service, and the gas was taken and the price agreed upon on this off-peak load basis (R. V. 2, pp. 801-956), and all such industrial customers acknowledged and conceded such priority or preference in favor of the sales to the distributing companies for resale to domestic customers. (R. V. 2, p. 1024.) Accordingly, it was incumbent upon every industrial customer to make his own arrangements for standby fuel and equipment to take care of such interruptions. (R. V. 2, p. 956.)

Evidence was introduced showing that within the period July 29, 1932, to December 31, 1940, this priority and preferential provision in the contracts had operated *in favor of the domestic customers* on forty different occasions. A table of these interruptions, showing the name of the industrial customer, the date of the beginning of the interruption, the duration of the interruption, and cause of the interruption, is set out in full in the Record. (R. V. 2, pp. 1026-1028.) Interruptions to the industrial customers of the distributing companies are shown under the name of the distributing

company. These forty interruptions ranged in duration from 5 hours to 66 hours. The causes of the interruption in service to such industrial customers were due to high domestic peak load or "freeze-ups" on the main line, or washouts on the main line. (R. V. 2, pp. 1026-1028.) The main pipe line in its course between Clayton, New Mexico, and Denver traverses many creeks, rivers and dry arroyos, and no matter how deep the line was laid and securely anchored, floods, and particularly "flash" floods, were able to cause washouts. (R. V. 2, p. 1030.) Despite these washouts, "freeze-ups" and high domestic peak loads, service was continued without interruption to the preferred domestic customers, even in case of total breaks of the line, because of the ability to use gas stored in the line, or the "line pack," for their service.

> "Beardsley explained that because of gas stored in the line or the 'line pack' the cutting off or cutting back of service to the industrial or commercial consumers always permitted service to the domestic users." (R. V. 2, p. 1028.)

Such use of the gas stored in the line or the "line pack" was explained by the witness Rhodes, who designed the line, as follows:

> "Furthermore, gas can be drawn from the line in excess of its true or continuous capacity through the skillful use of the storage capacity of the line. In long pipe lines a considerable amount of gas is stored in the line on account of the high pressure at which it operates. This stored gas under proper control may be used to supplement the flow capacity of the line to an extent of about 10 per cent for a single day." (R. V. 2, p. 1025.)

The Commission's witness, Kenneth L. Smith, testifying as to studies made by the Commission's Bureau of Engineering, stated:

> "According to information received from the Bureau of Engineering, the average line pack during the year 1939 was 55,362 Mcf., at a pressure base of 16.4 pounds per square inch absolute." (R. V. 2, p. 1025.)

It was by cutting off completely the industrial customers, when that was necessary, and by cutting back or reducing

the supply of gas to such industrial customers when that would suffice, and by the use of the gas stored in the line or the so-called "line pack," that service to the domestic consumers was continued without interruption in all cases despite washouts, freeze-ups, and high domestic peak loads. (R. V. 2, p. 1028.)

Evidence as to the Relative Use of Property for the Regulated and Unregulated Business, and Separation and Allocation of the Property and Expenses with Respect Thereto.

The Company's line was designed and built with a capacity calculated to take care of the maximum demands of the domestic consumers during the coldest weather. (R. V. 2, pp. 1108, 1118.) George I. Rhodes, chief engineer of Ford, Bacon & Davis, which firm was the designer and builder of the line, testified that prior to construction it was necessary to estimate volumes, peak loads and line capacity, and that the preconstruction estimates had been closely borne out. (R. V. 2, p. 1108.) The expense of building a line with capacity sufficient to deliver the maximum requirements of the domestic customers alone for house heating, cooking and other such purposes, that is, for the regulated business, on the coldest expected day in winter, would be prohibitive. (R. V. 4, p. 2298.) Nevertheless, it was necessary to have such capacity available for such domestic customers on the coldest days in order to make the project feasible, because domestic consumers would not buy the gas at all unless it was available on such days. (R. V. 4, pp. 2298, 2315; R. V. 2, pp. 1108, 1110.) He testified that the only solution was to find industrial customers willing to buy gas on an off-peak load or interruptible basis, sales to whom would thus contribute to the cost and operating expense of a line that would have sufficient capacity to take care of the maximum demands of the domestic customers in the coldest weather. (R. V. 4, pp. 2283-2307.) His firm actually designed and built the line with "the least capacity that could be provided to take care of the domestic obligations in the future years, the smallest line that you could reasonably expect to build." (R. V. 4, p. 2297.) Such line had ample capacity to take care of the Colorado Fuel & Iron (C. F. & I.) and the other industrial cus-

tomers on an off-peak load basis at practically no additional cost. (R. V. 4, pp. 2297, 2285.) He added that the line was so built, and that the direct sale industrial customers so acquired on the off-peak load or interruptible basis "must get off the line to the extent required to assure deliveries of domestic gas on the resale contracts." (R. V. 4, p. 2283.)

This witness Rhodes then testified as to the proper separation or allocation of the plant and expense of the whole Denver Line, as between direct sales not subject to regulation, and sales for resale now subject to regulation under the Act. (R. V. 4, pp. 2264-2355.)

The customers of Colorado Interstate to whom sales are made for resale off the Denver Line are: Public Service Company of Colorado, Pueblo Gas & Fuel Company, Citizens Utilities Company, Arkansas Valley Natural Gas Company (whose business has now been taken over by Citizens Utilities Company), City of Colorado Springs, and Colorado-Wyoming Gas Company. (R. V. 4, p. 2265.) (This business is by this witness, and other witnesses in the record, variously referred to as "sales for resale," which is the language of the Act, or as "resale" business, "regulated" business, and "jurisdictional" sales or business.)

The industrial customers to whom direct sales were made, and which sales are not now subject to regulation, are: American Crystal Sugar Company, Atchison, Topeka and Santa Fe Railway Company, City of Colorado Springs, for its power plant, C. F. & I., Colorado Portland Cement Company, and United States Government, for its Fort Lyon Hospital and for its helium plant at Thatcher, Colorado. (R. V. 2, pp. 1108, 1109; R. V. 4, p. 2265.) (This business is referred to by this witness, and other witnesses in the record, variously as sales "not for resale," "direct" sales, "unregulated" sales, "non-jurisdictional" sales or business.)

In making this separation, this witness Rhodes, in compliance with the terms of the Act, counted as "sales for resale" or as "regulated" business, the relatively minor amount of gas sold by Colorado Interstate to the several distributing companies for resale to industrial users. (R. V. 4, pp. 2265, 2268, 2269.)

The Commission's witness O'Connor also studied the deliveries of gas to the regulated and unregulated business in the year 1939, and charted the deliveries on the flow diagram map (R. V. 2, p. 1079), which is contained as Appendix B to this brief. O'Connor shows that except for the delivery to Colorado Portland Cement Company, all of the gas transported through the 20-inch pipe line from the Devine Station near Pueblo to Denver, a distance of 105 miles, is for resale, or is regulated business. This Commission's witness O'Connor on his flow diagram shows graphically that of the 21,107,096 Mcf which passes through the Clayton Compressor Station, 7,257,379 Mcf is delivered to the direct sale customer C. F. & I., at Pueblo, off the 22-inch main line extending between those points. (R. V. 2, p. 1079.) He also shows the other deliveries off this 22-inch portion of the line to the other industrial customers, all of which occur south of the Devine Compressor Station near Pueblo. (R. V. 2, p. 1079.)

Since, as testified to by Rhodes, the greater part of petitioner's property is used in the delivery of gas to both classes, he developed a method properly apportioning to the resale gas that part of the property used and held for use in meeting the obligations of petitioner to those customers having priority rights to line capacity.

As summarized hereinafter, Rhodes' testimony was that, based on the winter of 1939-1940, there should be assigned to the regulated business, because of its relative priority and consequent use, 84 per cent of the cost of the 22-inch main line between Clayton and the Devine Station (Pueblo), 99.48 per cent of the 20-inch main line from Devine Station to Denver, 58.2 per cent of the cost of the Arkansas Valley line, and 42.32 per cent of the cost of other laterals. The weighted average of the cost of all pipe lines assigned to the regulated business is 82.43 per cent.

Rhodes, describing his method, said:

"Certain facilities are devoted exclusively to the sale of resale gas and certain facilities exclusively to the sale of direct sale gas. By far the greater part of the property is used in the delivery of gas to both classes. This

exhibit develops a method by which there can be allocated to each class of business that part of the total costs fairly representing the share which each class of business should bear.

"Resale gas is the primary business of the Denver line. During peak loads this gas is supplied principally for resale to domestic and small industrial consumers, which constitutes the firm resale load of the line. They have the first call on all the gas in the line. Direct sale gas is the secondary business of the Denver line. This gas is for large industrial consumers served directly by Colorado Interstate. A large part of their requirements can be supplied by other fuels on short notice. The direct sale gas uses available spare capacity of the line when, as and if it is not needed by the resale gas. The same applies to resale gas for large industrial customers. It is appropriate that the firm resale gas with its dominant priority in the line should bear the base of underlying costs and that the direct sale gas and resale special industrial gas should bear the added or increment costs necessary to its supply.

* * * * *

"When two or more classes of business have equal rights at all times to a full and uninterrupted supply of gas from the pipe line then they have equal priority rights. If the available supply of gas from the pipe line is deficient for any cause then the supply to each of the classes of gas is curtailed in like proportion. Each class of gas having equal priority should share costs pro rata.

"When one class of business, however, has the first call on the available supply of gas from the pipe line and the other class of gas can take only that which is left, then that class of gas with the first call has a primary right or priority. In the event of shortage of gas, those classes of gas with inferior rights must, if necessary, suffer a complete interruption of service in assuring a full supply of gas to that class with the primary right. * * *" (R. V. 4, pp. 2265, 2266, 2267.)

This witness then refers back to his studies of, and testimony with respect to, the "Peak Load Obligations and Line

Capacity of the Denver Line" from 1928 through the winter 1939-1940. (R. V. 2, pp. 1108, 1118.) For each year of that history, he took the peak loads for two summer months, and the peak loads for two winter months, and from those actual operating results ascertained the relation between the decrease in temperature and the increase in the resale load or regulated gas load. (R. V. 2, pp. 1109, 1112, 1113.) This increase in the load of regulated business, he stated was due primarily to the house heating load. We quote the following from the record:

> "The use of gas for house heating begins in some form when the mean temperature falls below 65 deg. F., and such use increases practically in direct proportion as the mean temperature falls below 65 deg. F. The amount by which the mean temperature in any day falls below 65 deg. F. is called the 'degree day deficiency' for that day. For instance, if the mean temperature in any day is 55 deg. F., there are 10 degree days deficiency, and when the mean temperature is 45 deg. F. there are 20 degree days deficiency. The sum of the daily degree days deficiency during any period is known as the 'total degree days deficiency' for that period. In the Exhibit 'degree days deficiency' is abbreviated to 'Ddd'." (R. V. 2, p. 1110.)

From these studies of actual operating results, he determined that for every degree day deficiency in temperature the resale load increased 660,000 cu. ft. per day. (R. V. 2, p. 1110). These studies of actual operations during the history of the project confirmed the preconstruction estimates (R. V. 2, p. 1108) that the line should be built to take care of the domestic load at a mean temperature of 15 deg. F. below zero. (R. V. 2, p. 1111.)

The maximum demands which the Denver pipe line had to be prepared to meet in the event of extreme weather in the several areas are shown as follows:

	Mean Temperature On Coldest Day (Deg. F.)	Estimated Domestic Load On Such a Day (Cu. Ft.)
(a) Denver Area	—14 deg.	42,157,000
(b) Colorado-Wyoming Area	—20	10,775,000
(c) Colorado Springs Area	—16	3,251,000
(d) Pueblo Area	—10	2,230,000
(e) Arkansas Valley Area	—10	1,304,000
(f) New Mexico Area	—6	531,000
(g) Texas Area	—6	1,483,000
Total	—14.5 deg.	61,731,000

(R. V. 2, p. 1111.)

Having thus determined the increase in domestic load per day for each degree day of deficiency in temperature, based on operating results during the history of the line, he then simply calculated the maximum demands of the regulated gas which Colorado Interstate must be prepared to meet for each portion of the line. (R. V. 4, pp. 2268, 2269, 2270.) This demand he ascertained first in terms of percentage of the total flow capacity, and next in percentage of pipe diameter of the different segments of the line (R. V. 4, p. 2269), and, finally, in terms of cost (R. V. 4, p. 2271), which he stated as follows for the winter of 1939-1940:

	To Resale Gas Per Cent
22-Inch Main Line, Clayton Compressor Station to Devine (Pueblo) Compressor Station	84.00%
20-Inch Main Line Devine Station (Pueblo) to Denver	99.48
Arkansas Valley Lines	58.20
Other Laterals	42.32

(R. V. 4, p. 2271.)

As to the Compressor Stations, Rhodes stated:

"The first unit installed at each station is dedicated to and used practically continuously by the primary business on the line and therefore its cost should be borne entirely by the resale business. The costs of additional units of

the stations are chargeable both to resale gas and direct sale gas in proportions reflecting its use for the two services." (R. V. 4, p. 2272.)

He then analyzed the units at each station, and allocated to the regulated business 71.4% of the cost at Clayton Station, and also at the Canyon Station, and 94.5% of the cost at the Devine Station. (R. V. 4, p. 2275.) He then made a study of the telephone system and other general property, and arrived at percentage allocations for each class of such property. (R. V. 4, pp. 2276, 2278.) He likewise made similar allocations of all Colorado Interstate's expense incurred in delivering the gas. (R. V. 4, pp. 2275-2278.) These percentages of allocation or separation of cost and operating expenses were then applied to the Company's property and business. Property used exclusively in the regulated and unregulated business, respectively, and expenses incident to each class, were directly assigned. There was then presented by the Company complete statements of the cost of the property and the expenses applicable to the regulated business. Contrary to the statement in the Commission's Order (R. V. 1, p. 175), the petitioner did present such statements as to the cost of the property and expenses applicable to the regulated business. (R. V. 4, pp. 2263-2316; R. V. 5, pp. 2463-2494.)

Except for the evidence of the Commission's engineer O'Connor, above referred to, no Commission witness offered any testimony as to a separation of the Company's plant or physical properties, as between that used in the regulated and unregulated business respectively. (The absence of such testimony on the part of the Commission's witnesses at the hearing may be explained by the Commission's declaration in its Opinion that "It does not follow, from this obligation of the Commission, that an allocation of physical property or portions thereof, must be made, before any excessive returns are determined, as seems to be the contention of the companies." (R. V. 1, p. 175.))

4. THE COMMISSION'S EVIDENCE AS TO ALLOCATION OF COSTS OF SERVICE.

The accounting witness for the Commission made adjustments by way of deduction in the original cost and in the operating expenses. This was done for Colorado Interstate and Canadian separately. Then another accounting witness consolidated all of these revised accounts of the two companies as if they were one, reflecting in such consolidated figures all of such adjustments, and in this consolidated showing the transaction between the two companies, involving the sale and purchase of gas at Clayton, New Mexico, was washed out. (R. V. 4, pp. 2215-2259.)

The Commission's witness Lyon then took these consolidated "adjusted" accounts for the combined companies and made his allocation of costs of service (R. V. 4, p. 2317; R. V. 5, p. 2450), showing as part of the cost a 6 per cent rate of return on all of the property used in the business, regulated and unregulated. (R. V. 5, p. 2409.) He made no separation or allocation of the property itself, either as between that used in intrastate commerce and that used in interstate business, nor as between that used for resale gas and that used for direct sale gas. (R. V. 4, pp. 2317-2373.) He stated:

> "I have made no allocation, segregation of the property specifically devoted to the service of either of those markets." (R. V. 5, p. 2422.)

On the basis of such combined adjusted costs furnished him by other Commission accountants and examiners, Lyon sought to derive an average or unit "Production Cost." This cost he showed under the heads (1) "Cost of Gas at Wellhead," (2) "Cost of Gathering," and (3) "Residuals—Refining." This third classification is in fact not a "cost," but a credit against the other two classes of costs, and represents the revenue derived from extracting the lighter vapors from the raw natural gas so as to lessen the possibility of "line freezes" during transportation. He admitted that his production costs were average costs derived without any regard as to whom or under what circumstances the gas produced was sold—whether sold to the Denver Line, the Chicago Line, or whether it was intrastate or interstate commerce,

or whether it was the subject of direct sales not subject to regulation, or sales for resale subject to such regulation.

"A. It is an average cost of the gas at the wellhead and is an average cost of the gathering—

"Q. If the word 'system' means the production system or gathering system, that is the system cost?

"A. That is correct." (R. V. 4, p. 2397.)

His attention was called to the fact that the sales for resale had priority over direct sales to industrial customers, and that the "system" had been built and maintained for the preferential and priority service to the sales for resale to the domestic consumers, that is, regulated business. He was asked if in view of those facts it was not improper to use the same average costs for gas for both businesses, that is, the preferred or priority regulated business, and the subordinate and unregulated business, and whether or not it would not be more appropriate to assign a lower or mere incremental cost to such unregulated business. (R. V. 4, pp. 2390-2397.) He replied:

"A. I think the incremental cost feature should be forgotten." (R. V. 4, p. 2397.)

He was also asked whether his "average cost" did not ignore the load factor obtaining and operating in variable favorable or unfavorable degrees with respect to the several classes of business. He admitted that the load factor was of consequence in determining cost, but also admitted that he had ignored it. (R. V. 4, pp. 2390, 2391; R. V. 5, pp. 2414, 2415.)

"Q. What is the significance of the load factor?

* * * * *

"A. Load factor is the ratio of the average load over a designated period to the peak load occurring in that period.

* * * * *

"A. The load factor of gas deliveries is a matter of consequence in determining the cost of rendering the service. (R. V. 4, p. 2390.)

* * * * *

"Q. Now, having gotten this average cost of gas at the wellhead, you applied that to the volume which various customers, shown on Table 1 of your exhibit, took during the year 1939?

"A. Yes.

"Q. Now, I take it that you gave no consideration to the question of load factor of the various deliveries of gas which Canadian River Gas Company makes; that is, as between deliveries made to Bivins for the Denver Line, as we call it, and deliveries that are taken at the wellhead for the Amarillo Oil Company and deliveries that are made to the Fritch Compressor station of Texoma Natural Gas Company?

"A. No, no effect was given to load factor in this allocation." (R. V. 5, p. 2414.)

He agreed that the load factor on the Chicago Line was 95 per cent, or perhaps a little under that, whereas the factor on the Denver Line was only somewhere "between 60 and 70 per cent." (R. V. 5, p. 2415.) Although admitting that the Chicago Line had the better or cheaper operating load factor, he gave that fact no effect.

"Q. And given no effect to the fact that there is a different load factor between the Denver line and the Chicago line?

"A. No effect." (R. V. 5, pp. 2421, 2422.)

Neither did he give any effect to the difference in the maximum monthly demands.

"Q. Now, again, you have given no effect to the difference in maximum monthly demand which is made by the Denver line on the gathering system as compared with the maximum monthly demand which the Chicago gas line demands.

"A. That is again on a uniform volumetric base." (R. V. 5, p. 2421.)

After thus allocating his "Production Cost" on a straight volume or average basis, he then allocated Transmission Costs. (R. V. 4, p. 2317, columns 6, 7 and 8.) These "Transmission Costs" he divided into two parts (1) "volumetric

costs" and (2) "capacity costs." (R. V. 4, p. 2317, Table 1; R. V. 5, p. 2423.)

In allocating his Transmission Costs he treated as a unit, and as if it were one common conduit used by *all* gas, all the transmission system beginning with and including Canadian's Bivins Compressor Station in the field, its transmission line from that point in Texas, with all laterals used in making intrastate deliveries in Texas, and all of Colorado Interstate's transmission line to Denver, with all of its laterals, even though some laterals were used exclusively in delivering direct sales of gas to industrial customers not now subject to regulation. (R. V. 5, pp. 2427-2431.) This transmission system which he treated as a unit or a common conduit he discussed by reference to the Commission's Engineer O'Connor's map, reproduced as Appendix B hereto. (R. V. 5, pp. 2425, 2427.) His attention was directed to the fact that on this flow diagram map of the Commission's Engineer O'Connor, it appeared that of the 21,594,112 Mcf of gas which passed through the Bivins Station in 1939, 7,257,379 Mcf were sold directly to C. F. & I. at Pueblo as a direct sale not subject to regulation, and that this gas made no use whatever of his assumed unit or common transmission system *north of Pueblo*. (See Exhibit 138, Appendix B hereto.)

His attention was likewise directed to the fact that this same Commission's flow map showed for the same year, 1,676,091 Mcf deliveries of direct sale or unregulated gas to Colorado Portland Cement, slightly north of Pueblo, and that north of the Devine Station, the 20-inch line (compared to the 22-inch line south of Pueblo) was used almost exclusively by the resale or regulated gas. (R. V. 5, pp. 2426-2429.) However, he admitted that in computing his "volumetric cost" component of his total Transmission Cost, he gave no consideration to such facts, and he admitted the consideration of such facts would produce a different "volumetric cost" for the regulated and unregulated gas.

"Q. If instead of using this as one system if we blocked it out and took this 22-inch portion of the line and determined the volumetric portion there and prescribed that to every thousand cubic feet of gas that flows through

it, and if we came on up the line, and when we got to the 20-inch line we made that same determination and applied those volumetric costs only to that portion of the gas which flows to that portion of the line, we come out with a different volume unit cost applied to these different customers, don't we?

"A. If you applied costs in a manner different than what I have in this exhibit—

"Q. I mean if we applied it in the manner I stated by allocating the cost of the line to the gas that flows through that line.

"A. That is correct, you would.

"Q. We have a higher volume cost to apply for the Denver gas than we would have for the Colorado Fuel and Iron Corporation or that we would have for the gas that goes into the laterals in the Arkansas Valley?

"A. Your cost would be cumulative, that is correct.

"Q. So that the result of your system of doing this is in effect to build up the cost of service of this direct sale gas which the company sells, isn't it, and reduce the cost of serving the gas that goes all through the line clear to the end of it and is sold for resale purposes only?

"A. I don't follow your direct sales and resales.

* * * * *

"Q. Will you for the purpose of this discussion—when I say 'direct sale gas,' I mean gas the pipe line company sells for consumption, and when I say "resale gas,' I mean gas that it sells to distributing companies, for example, the City of Colorado Springs for resale or distribution.

"You are familiar with the fact that all of the direct sale gas the pipe line company sells for consumption, the main part of it is delivered at Pueblo or south of Pueblo, and then to the Colorado Portland Cement Company just north of Pueblo.

* * * * *

"Q. So that as I say, the result of your method is to tend to increase your computed cost of gas that this pipe line sells to these industries for consumption and to cor-

respondingly reduce that that goes all the way through the line and comes out at Denver?

"A. I give no consideration as to whether the delivery is made to an industry or to a distribution plant or if it is resale gas or direct consumption. It is a factor, of course, under the method you have outlined that the farther the gas flows the more costs there are to accumulate. Under the method I have followed the geographical distribution of the load within that common cost zone is of no consequence." (R. V. 5, pp. 2429, 2430, 2431.)

In substance, he stated that his Transmission Costs were computed as if all the gas went into a common conduit at Bivins, and came out a common vent at Denver. (R. V. 5, pp. 2428-2431.)

Included in his Transmission Costs were costs due to compression of the gas at the several compressor stations, but in deriving this cost he gave no consideration to the number of times the gas had to be compressed before it was delivered to the respective customers, such as the delivery of the unregulated gas to C. F. & I. at Pueblo, and such as the delivery of the "regulated" gas 105 miles farther on to Public Service Company at Denver, and with respect to which additional compression had to be made. (R. V. 4, pp. 2396-2399.)

"Q. * * * Isn't it true you have considered the Colorado Interstate Gas Company as one common zone? You have not divided it into more than one common cost zone?

"A. The transmission system, that is correct. * * *.

"A. I have treated the transmission system as a single enterprise and have applied the common costs as the basis of determination to all points of delivery in that system.

(R. V. 4, p. 2399.)

• • • • •

"Q. I want to ask you with reference to this Exhibit No. 138 which was prepared by Mr. O'Connor, the flow chart showing where the gas comes in where it goes out—you are familiar with that?

"A. Yes, that is Mr. O'Connor's map.

"Q. Here is the delivery, say at Dalhart, Texas, which is a few miles away from Bivins. For every thousand

cubic feet which is taken out of the line at Dalhart you apply that volumetric factor of three cents plus?

"A. Yes, I have.

"Q. So that for every thousand cubic feet of gas taken out at Denver you would again apply that three cents?

"A. That is correct. (R. V. 5, p. 2425.)

* * * * *

"Q. The fact that the gas going to Denver is compressed four times doesn't result in any greater charge against the gas delivered at Denver under your method than the gas that is compressed only once?

"A. That is correct." (R. V. 5, p. 2448.)

His allocation of costs as between the regulated and unregulated business, that is, the direct sales to industrial customers taking gas under the shut-off provisions, gives no consideration to any such curtailments or shut-offs. (R. V. 5, p. 2439.) His allocation of costs is based on operations during the year 1939; and he stated:

"During the year 1939 I have given no effect to any curtailment of service by reason of insufficient pipe line facilities. * * *." (R. V. 5, p. 2439.)

And again:

"A. * * * A dormant clause in a contract which is not exercised and may not be exercised for the life of the contract is a speculative matter." (R. V. 5, p. 2439.)

In this respect, he did not consider or give effect to the fact that these contract clauses had in fact operated on 40 different occasions, because of high domestic peak load or "freeze-ups" on the main line, or washouts on the main line, each resulting in gas deliveries to the direct sale customers, or in the unregulated business, being cut off or cut back for periods ranging from five hours to sixty-six hours. (R. V. 2, pp. 1026-1028; R. V. 5, p. 2439.)

In computing the "capacity cost" component of his "Transmission Costs," he did not give effect to the priority and preferential service rendered in the regulated business just described, and he did not give consideration to the relative use of the line which the regulated business might de-

mand *on the coldest expected day*, but merely took deliveries of regulated and unregulated gas as they happened to occur on February 9, 1939, which he called "the system's peak delivery day," for that particular year. (R. V. 5, pp. 2434-2436; R. V. 4, p. 2319.) He did not testify as to the temperature on that day, but he did state that the total delivery of regulated gas at the Denver gate on that particular day was only 36,104 Mcf. (R. V. 5, p. 2434.) On the basis of the delivery to the regulated and unregulated business on that particular day of that year, he made all of his divisions of "capacity cost" as between the regulated and unregulated business (R. V. 5, pp. 2434-2436; R. V. 4, p. 2319); and in making such division of his capacity costs he treated *all* of the gas as if it entered the transmission system or common conduit at Bivins, and as if such gas used or was transmitted through every part of such unit transmission system, and all came out at one common vent at Denver. (R. V. 5, pp. 2422-2448; R. V. 4, pp. 2317-2373.)

The witness Lyon in his treatment of capacity costs placed all industrial gas in one category, irrespective of whether it was sold directly by Colorado Interstate or sold to the distributing companies for resale. Using his peak day demand as of February 9, 1939, when, as the United States weather reports hereinafter referred to show, the mean temperature was 8 deg. above zero, and much warmer than the coldest temperature experienced and to be expected in the area, he stated (R. V. 4, p. 2319, line 51, columns 7 and 8) that the total industrial sales, both regulated and unregulated (column 8) were 52,328 Mcf, and the regulated domestic and commercial gas sales (column 7) were 42,670 Mcf. The industrial gas, both regulated and unregulated, is shown as 55.083 percent of the total sales on that day, and the domestic and commercial gas, being all regulated, is 44.917 percent of the load. These percentages are used by Lyon in computing his "capacity cost" component of his "transmission cost" as between the industrial gas, both regulated and unregulated, and the domestic and commercial regulated gas. He made no attempt to classify the industrial gas between resale gas and direct sale gas, treating all gas on the basis of the character of consumption rather than whether it was subject to regulation or not. (R. V. 5, pp. 2441-2442.) His

determinations evidently were adopted by the Commission, although the Commission's Opinion does not disclose the manner in which it actually separated the direct industrial sales from sales made for resale to industrial customers.

Petitioner's evidence (and it was undisputed) contradicting the Commission's evidence, showed the actual peak demands on January 24, 1940 (R. V. 4, p. 2269), when the mean temperature was 1.5 deg. below zero, and far above the lowest temperature experienced and to be expected in the area (R. V. 4, p. 2268). It was there shown that on that actual peak day in January, 1940, sales of the regulated gas amounted to 67,783 Mcf as against the direct sales of gas in the amount of 47,343 Mcf. These figures cannot be compared with those of Lyon referred to above, since petitioner's evidence states the volumes in terms of regulated and unregulated gas. Petitioner's witness then translated such actual peak day demand into what would have been the peak day demand had the mean temperature been 15 deg. below zero, and showed that the load would have been 79,385 Mcf for the regulated and 47,343 Mcf for the unregulated gas. This is to be compared with the ratios used by Lyon on his selected day when the mean temperature was 8 degrees above zero.

The allowed return of 6 per cent on petitioner's property was divided by the witness Lyon equally between volumetric costs and capacity costs. Income taxes were allocated as was return.

Thus the witness Lyon, beginning with the adjusted cost furnished him by the other Commission accountants and examiners, which reflected all of the adjustments and deductions made by these witnesses, then made the foregoing allocations and derived what he called "allocated cost." He then compared these allocated costs with the actual revenue received in 1939 from each customer, regulated and unregulated. (R. V. 4, p. 2317.) (Although this evidence of its witness Lyon was the only evidence presented by the Commission at the hearing on this subject of allocated cost; and from which it derived its so-called "excess revenue" over "costs," we are not able to identify or reconcile this evidence as to his "allocated costs" with the costs used by the Commission in its Order. (R. V. 1, p. 181.))

SPECIFICATION OF ERRORS.

1. The Commission, in purporting to fix reasonable rates for gas sold by the petitioner for resale in interstate commerce, and now subject to its regulation, violated the requirements of the Fifth Amendment to the Constitution of the United States and of the Natural Gas Act when it treated petitioner's property and that of Canadian as a unit, and failed to make any separation of the property and expenses as between that applicable to interstate commerce and that applicable to the intrastate sales in Texas, or between that applicable to the sales for resale and that incident to the direct sales to industrial customers over which it has no jurisdiction; and the Circuit Court of Appeals erred in affirming the Order.

2. The Commission's "allocation of cost of service" is not a valid substitute for the required separation of property and expenses, in that it results in burdening non-regulable gas with costs actually incurred in the sale of the regulable gas, and in the regulation of business over which it has no jurisdiction, contrary to the limitations of the Fifth Amendment and of the Natural Gas Act; and the Circuit Court of Appeals erred in affirming the Order.

ARGUMENT.

The basic question presented to this Court is one of jurisdiction. Admittedly, the jurisdiction of the Commission extends only to sales of natural gas made in interstate commerce for resale. Sales made by natural gas companies in intrastate commerce and those made in interstate commerce directly for consumption are not subject to the jurisdiction of the Commission. (Section 1, Natural Gas Act, Appendix A.) The Commission so recognized this lack of jurisdiction in principle (R. V. 1, pp. 174-177), as did the Circuit Court of Appeals. (R. V. 8, p. 5087; 142 Fed. (2d) 943, 958.) However, in arriving at its conclusions as to petitioner's rates, this jurisdictional principle was forgotten by the Commission, and completely disregarded by the reviewing court.

The gas sold directly to industrial customers for consumption amounted in 1939 to 11,663,832 Mcf at contract pressure base. Gas sold for resale from the Denver Line amounted to 11,598,073 Mcf at contract pressure base, of which 6,818,497 Mcf was for domestic and commercial consumption, and 4,779,576 Mcf for industrial consumers of the distributing companies. (R. V. 2, p. 1105.) We are dealing with a substantial part of petitioner's business in our consideration of the action of the Commission in the assignment of costs to the unregulated business.

We are not now concerned with the correctness of the Commission's action within the ambit of its statutory authority. The rules for testing the validity of a commission order stated in the cases of *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, and *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, can have no application here. In those cases this Court dealt with action taken by the Commission on matters over which Congress had conferred jurisdiction upon the Commission. In declining to go into the methods employed by the Commission in fixing rates in those cases, and in looking only to the result of the rate orders in their totality, this Court limited such rules to jurisdictional action. As said by this Court in the *Natural Gas Pipeline* case:

"* * * Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances. Once a fair hearing has been given proper findings made and other statutory requirements satisfied, the courts cannot intervene in the absence of a clear showing that the limits of due process have been overstepped. If the Commission's order, as applied to the facts before it and viewed in its entirety, produces no arbitrary result, our inquiry is at an end."

In the *Hope Natural Gas* case this Court reaffirmed the position previously stated, and added that

"* * * Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. * * * It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important."

The Circuit Court of Appeals in its consideration of the Commission's order failed to observe the distinction between action by the Commission within and action without the ambit of its statutory authority. After reciting the illegalities in the Commission's method of cost allocation, as contended for by petitioner, the Court said:

"* * * It may be conceded, without deciding, that the method is not free from defects or imperfections in all its aspects. But even so it cannot be said that as the consequence, the impact of the orders of reduction, each in its totality, produces arbitrary results or oversteps the bounds of due process. Therefore the orders are not open to further judicial inquiry on these grounds. Federal Power Commission v. Natural Gas Pipeline Co., supra; Federal Power Commission v. Hope Natural Gas Co., supra." (R. V. 8, p. 5088; 142 Fed. (2d) 959.)

The judicial inquiry by this Court must be directed to the methods employed by the Commission in order to determine

if the Commission transgressed the jurisdictional limits imposed by Congress.

As the evidence indisputedly shows, the Commission accountants, after dealing with Colorado and Canadian Companies separately, and after rejecting from the rate base of each the original cost of considerable items of property, and after computing for each company large depreciation book reserves which it treated as representing accrued depreciation in the property which they deducted in each case from the "original cost" and "rate base" of each company, and after adjusting downward the annual expenses of each company, they then, very strangely, consolidated these accounts, so adjusted by them, into one account, or "pot," if it may please the Court. This conglomerate included the revenues and expenses of Canadian Company in respect to its intrastate sales in Texas, and it, likewise, included the revenues and expenses of both companies in respect to direct sales of gas to industries not now subjected to regulation under the Act. This conglomerate included as part of the "cost of service," a so-called "fair return" upon the property which the Commission witness Lyon, in his testimony, fixed arbitrarily, as he admitted, at 6 per cent (R. V. 5, p. 2408), but which the Commission in its Opinion raised to 6½ per cent (R. V. 1, p. 173). This return, so limited, was used for the unregulated as well as the regulated business in determining the cost of service. From this conglomerate, the Commission witness Lyon attempted, without any separation of the property as between the intrastate and interstate, or between the resale and direct sale, or the regulated and the unregulated business, to allocate the cost of service in respect to the regulated business. It is to be remembered that this conglomerate, which Lyon thus sought to allocate was based upon the consolidated accounts of the two companies, but very strangely, the Commission in its Opinion, for some reason, departed from the testimony of its own accountants, and sought to derive an allocated cost for each company separately. We, ourselves, have never been able to ferret out just what the Commission did, because of its failure to make appropriate findings with respect to this matter. We do know that the Commission took the cost of service, in some

manner derived by it, and which, as above stated, we cannot identify with the cost testified to by its witnesses, and then compared those costs to the Company's actual revenues in 1939, and finally derived what the Commission called "excess revenues," upon which the ordered rate reductions were based.

With this preliminary statement, we now deal with our two questions and Specification of Errors.

1. *The Commission, in purporting to fix reasonable rates for gas sold by the petitioner for resale in interstate commerce; and now subject to its regulation, violated the requirements of the Fifth Amendment to the Constitution of the United States and of the Natural Gas Act when it treated petitioner's property and that of Canadian as a unit, and failed to make any separation of the property and expenses as between that applicable to interstate commerce and that applicable to the intrastate sales in Texas, or between that applicable to the sales for resale and that incident to the direct sales to industrial customers over which it has no jurisdiction: and the Circuit Court of Appeals erred in affirming the Order.*

That the Commission failed to make such a separation or allocation is, of course, candidly admitted in its Opinion:

> "The Commission is aware that in an investigation such as this it is incumbent on it to determine the reasonableness or unreasonableness of the rates and charges subject to its jurisdiction. * * *
>
> "It does not follow, from this obligation of the Commission, that an allocation of physical property or portions thereon, must be made, before any excessive returns are determined, as seems to be the contention of the companies." (R. V. 1, pp. 174, 175.)

Now where property is used in public service, it is universally acknowledged that the owner must be paid for that use. Where the owner uses such property only part time, or uses only a part of the whole property in such service, he is only entitled to be paid to the extent of that use. Where he devotes the same property during a part of the time, or

a part of the whole property, to some purely private venture, he can demand for such use in such private venture simultaneously carried on, whatever compensation may be agreed upon between him and the other parties in interest. The owner is not limited to any specific rate of return on his investment, as is done where a public service is rendered. This being the case, it would seem to follow, from a simple application of common sense, and without any elaborate argument, and without any citation of authority, that a separation of the property, based upon use, must be made in order to determine the payment that is due for such use in the public service. This proposition is so not only as a matter of plain common sense, but it exists in this case as a matter of jurisdictional limitation, imposed both by the constitution and the statute. It was incumbent upon the Commission, as an administrative body, in order not to transcend its jurisdiction, to draw and observe two jurisdictional boundaries: first, the boundary line between intrastate and interstate commerce, and, second, the boundary between sales for resale and direct sales not subject to regulation under the Act. It is circumscribed by each of these boundaries.

This Court has laid down these axiomatic limitations on administrative boards and commissions in emphatic language. In *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133, 146, where intrastate rates were involved in a state commission order, and where some of the property was used in common for intrastate and interstate business, Chief Justice Hughes said:

> "At the threshold of the discussion, we are met with the fact that, in these findings, the commission and the court made no distinction between the intrastate and the interstate property and business of the company. It appears that the property of the company in Chicago is used to render (1) what is called exchange service, all of which is intrastate, (2) intrastate toll service over its own lines and under arrangements with companies other than the American Company, and (3) interstate toll service, which includes all the toll service rendered under arrangements with the American Company. The company introduced evidence separating the intrastate and interstate business

and also the intrastate exchange business. While the court regarded these computations as correct, and approved the method in which they had been made, still the court made no specific findings based on a separation of the intrastate and interstate property, revenues and expenses, but determined the issue on the basis of the total Chicago property of the company.

* * * * *

"The separation of the intrastate and interstate property, revenues and expenses of the company is important not simply as a theoretical allocation to two branches of the business. It is essential to the appropriate recognition of the competent governmental authority in each field of regulation. * * * The proper regulation of rates can be had only by maintaining the limits of state and federal jurisdiction, and this can not be accomplished unless there are findings of fact underlying the conclusions reached with respect to the exercise of each authority. In view of the questions presented in this case, *the validity of the order of the state commission can be suitably tested only by an appropriate determination of the value of the property employed in the intrastate business* and of the compensation receivable for the intrastate service under the rates prescribed. * * * As to the value of that property, and as to the revenue and expenses incident to that business, *separately considered*, there should be specific findings. Railroad Commission v. Maxey, 281 U.S. 82, 83, 74 L. Ed. 717, 718, 50 S. Ct. 228." (Emphasis supplied.)

The same rule was announced in the *Minnesota Rate Cases*, 230 U.S. 352, 435, in the following language:

"Where the business of the carrier is both interstate and intrastate, the question whether a scheme of maximum rates fixed by the state for intrastate transportation affords a fair return *must be determined by considering separately the value of the property employed in the intrastate business* and the compensation allowed in that business under the rates prescribed. This was also ruled in the Smyth Case (id. p. 541). The reason as there stated, is that the state cannot justify unreasonably low rates for domestic transportation, considered alone, upon the ground

that the carrier is earning large profits on its interstate business, and, on the other hand, the carrier cannot justify unreasonably high rates on domestic business because only in that way is it able to meet losses on its interstate business." (Emphasis supplied.)

This opinion also most emphatically rejects the notion that this required separation of property or separation of capital items and expenses incident thereto can be substituted for by any formula based merely on revenue and expenses, or cost accounting, or particularly, as in that case, revenue; a thing akin to what the Commission attempted to employ in this case. The fallacy of this attempted substitute, of course, lies in the fact that such a process involves circuitous and inconclusive reasoning or argument, or is just another illustration of the dog chasing his tail. The Court in this *Minnesota Rate Case* continued by saying with respect to this method:

"When rates are in controversy, it would seem to be necessary to find a *basis for a division of the total value of the property* independently of revenue, and this must be found in the use that is made of the property. That is, there should be assigned to each business that *proportion of the total value of the property* which will correspond to the extent of its employment in that business. * * *." (Emphasis supplied.)

In the cases we have cited, the jurisdictional boundary line being considered was that between intrastate and interstate business, which directly concerns us here, but the principle of the foregoing decisions, as is specifically indicated in *Smith v. Illinois Bell Telephone Co.*, supra, also applies with equal force to cases where the jurisdictional boundary is that line between regulated and unregulated business, with which we are also here concerned.

See also:

Wabash Valley Electric Co. v. Ralph M. Young, et al., 287 U.S. 488, 493, 77 L. Ed. 447, 451.

Illinois Bell Telephone Co. v. Moynihan, et al., 38 Fed. (2d) 77, 83.

United Fuel Gas Co. v. Public Service Commission of West Virginia, 14 Fed. (2d) 209, 224.

Our case is to be distinguished from those cases where here are no jurisdictional questions and no combinations of egulated and unregulated business. Such, for example, vas *Columbus Gas & Fuel Co. v. Public Utilities Comnission of Ohio,* 292 U.S. 398, 408. This case was cited y the Court below as authority to sustain the Commission's ailure to make a separation of property in the instant case. pparently the Court below failed to realize that in that ase the Commission had complete jurisdiction over all of the perations of the Company in Ohio, and there was no combiation of regulated and unregulated business, and the only llocation there involved or necessary was as between the unicipality of Columbus and other municipalities in Ohio. ther cases involving a like situation may be found and cited y respondent, but, obviously, they are inapplicable.

The Commission witnesses, and the Commission itself in its pinion, all concede that the direct sales to industries are not ubject to regulation under the Act. They could not take any ther position, in view of the plain language of the Act itself, nd in view of the discussions in Congress preceding its enactnent (Vol. 81, No. 124, Congressional Record, July 1, 1937, p. 675, et seq). Congressman Lea, the author of the Bill, stated the Committee hearings, and on the floor, that direct sales industrial companies (such as C. F. & I. in this case) for heir own private consumption were not intended to be regu-ted, and would not be affected by the Act.

This Court in the cases above cited has recognized the fficulties that are sometimes encountered in making a sepration of property or capital employed in the business subect to the jurisdiction of the regulatory board from that not ibject to its jurisdiction. But, as it also points out, such fficulty affords no excuse for failing to make such a seplation. *Simpson v. Shepard* (Minnesota Rate Cases), 230 .S., at page 432. Furthermore, there is no great difficulty making a separation, as demonstrated by the separations ade by the Company in this very case. That evidence was at the witness Rhodes, who checked the design of the line. d whose firm constructed the line and operated it for some ars under a management contract, with his engineering astants, made a separation of the property and the capital

items with respect thereto, based upon the actual use of the property in the two businesses. The Commission witnesses did not challenge the accuracy of that separation. The Commission, in its Opinion, does not challenge the accuracy of that separation, but simply ignores it. In this connection, we want to point out that we were under no burden or obligation to make any such separation. The Commission was challenging our *contract prices* agreed upon by our Company and its contract customers in 1927, or thereabouts, in contracts that were to continue for 20 years. (R. V. 2, pp. 801-846.) The Commission, in its Opinion, admits that it was incumbent upon it to establish the unreasonableness of those prices as a condition precedent to any reduction, and this, of course, is elementary law. *Wichita Railroad and Light Co. v. Public Utilities Commission*, 260 U.S. 48. If the case were different, and we were involved in a proceeding where the Company was before the Commission petitioning for an increase in rates *which had been originally fixed through the regulatory process*, which had been in effect for some time, and which, therefore, were presumably reasonable, then it might be incumbent upon petitioner to separate out its regulated business from the unregulated business, in order to sustain the general burden imposed upon petitioner in that assumed situation of demonstrating that the rates for the regulated business were unreasonably low. But that, as the Commission itself admits in its Opinion, is not our case. (R. V. 1, p. 174.)

The Commission has not contended, and it could not contend, that the Natural Gas Act itself furnishes any basis for its failure to make a separation of the property and expenses, as required by the decisions of this Court above discussed. This Court, in *Federal Power Commission v. Hope Natural Gas Co.*, supra, thus characterized the Natural Gas Act:

> "The Committee Report stated that the Act provided 'for regulation along recognized and more or less standardized lines' and that there was 'nothing novel in its provisions.' H. Rep. No. 709, supra, page 3."

Furthermore, when the Federal Power Commission through its solicitor, Mr. Dozier De Vane, appeared before the Com-

mittee on Interstate and Foreign Commerce of the House, to explain the provisions of Section 211 (a), which later became Section 208 of the Federal Power Act, the principle of separation of property was acknowledged as follows:

"Mr. De Vane. Yes sir; that is one of the sections that I referred to in connection with section 201.

"You will find that subsection (a) of section 211 provides that the Commission shall have power to ascertain for the purpose of this bill, actual legitimate prudent cost of the property of every public utility and every fact which, in its judgment, may or does have any bearing on the determination of such cost.

"Now, that fits right into the picture of the *separation of this property* between State and Interstate use.

"In this separation, we know of no way of dividing it other than that specified by the Supreme Court of the United States in the Minnesota rate case. Where you can ascertain the cost of the *property*, you can readily determine what percentage of the *property* is used in interstate commerce, and what percentage is used in intrastate commerce, and you can divide for the benefit of the Federal Commission and the State commissions that part of the *property* that is used in interstate commerce, which will determine rates, and that part that is used in intrastate service, upon which intrastate rates will rest." (Emphasis supplied.)

Hearings Before the Committee on Interstate and Foreign Commerce, House of Representatives, 74th Congress, First Session, on H. R. 5423, page 505.

Section 6 (a) of the Natural Gas Act was based upon Section 208 of the Federal Power Act, and the comments of Mr. De Vane are pertinent thereto.

The separation of *physical properties*, which the Commission's spokesman there conceded would have to be made between the interstate and the intrastate business excluded by the Constitution, would, of course, be equally necessary as

between the resale business and the direct sales to industrial customers excluded by the terms of the Act.

The Commission in its Order having candidly admitted that it made no separation of the property (R. V. 1, pp. 174-175), it not only follows that its conclusions as to reasonable rates for the regulated business are based on mere guesswork and speculation, but more importantly, it also follows that the Commission has failed to observe and has transgressed two jurisdictional boundary lines. The first jurisdictional boundary line between interstate and intrastate business is laid down both by the Constitution and the Natural Gas Act; and the second, the boundary dividing interstate sales into those for resale and those made directly to industrial customers, is laid down by the Natural Gas Act. This error is jurisdictional and vitiates the entire Order. No appraisal by this Court of the "end result," or of the rates fixed as being reasonable, can possibly excuse these demonstrated transgressions of constitutional and statutory limitations on jurisdiction.

2. *The Commission's "allocation of cost of service" is not a valid substitute for the required separation of property and expenses, in that it results in burdening non-regulable gas with costs actually incurred in the sale of the regulable gas, and in the regulation of business over which it has no jurisdiction, contrary to the limitations of the Fifth Amendment and of the Natural Gas Act; and the Circuit Court of Appeals erred in affirming the Order.*

It is inconceivable to us that this Court can approve this Order in the face of the Commission's admission that it made no separation of the property, and in view of this Court's repeated direction that in all such cases where jurisdictional limitations are involved and there is a combination of regulated and unregulated business, a separation must be made in order that there may be determined for the regulated part of the business proper operating expenses, annual depreciation of property, and an appropriate return upon the property used in the regulated business. But, in any event, the Commission's attempted substitute or "allocation of costs," since it fails to include at any stage a separa-

tion of property based on use, not only operates to regulate business over which the Commission has no jurisdiction, but in fact siphons costs from the regulated sales to the detriment of the unregulated business, and appropriates earnings from the unregulated business in order to effect a reduction in rates for the regulated; all of which deprives petitioner of its property without due process of law. The Commission's method produces these unconstitutional results.

Some of the errors in the method are easily demonstrated because they arise from a disregard of material facts which, as will be hereinafter pointed out, the Commission itself in its Opinion admits it disregarded. Other errors may not be so easily displayed, for the reason that the Commission failed to make appropriate findings on this matter. Except for announcing the final figures as to cost and comparing them to the Company's revenues for the year 1939, in order to direct a reduction for the future in such revenues, the Commission resorts to generalities. It says:

> "All that can be accomplished by an allocation of physical properties can be attained by allocating costs including the return. The latter method is by far the most practical and business-like.
>
> * * * * * * *
>
> "Commission staff exhibits on cost allocation followed principles that have long been recognized as reasonable in the public utility field and are widely accepted. Therein costs are divided essentially into two groups, fixed and variable. Fixed costs are largely joint costs which do not vary with volume of sales. The total amount of such costs are largely proportional to the maximum demand on the system or system capacity. Accordingly, these costs have been allocated basically in proportion to each customer's responsibility for the peak day demand. Variable costs are largely those that vary proportional to output or volume of sale. Accordingly, these costs have been allocated in proportion to volume of gas purchased by each customer.
>
> "The principles and methods of cost allocation presented by Commission staff are obviously the most appropriate and reasonable for Canadian and Colorado Com-

panies. Applying the physical and operating data submitted in evidence by Commission staff to total costs for each company results in the allocations shown in the following table. * * *." (R. V. 1, p. 175.)

The Commission gave no references to court or commission decisions, text book citations, or articles in trade journals in support of its contention that its method of cost allocation was a recognized one in the public utility field, was the most practical and businesslike, and widely accepted. The legal authorities are decidedly to the contrary, as we have shown.

The Commission then announced its final "allocated costs." These announced costs in the Commission's Opinion cannot be identified with the costs derived by Lyon, its only witness on this subject. For example: Lyon never did derive or announce any cost to Colorado Interstate for gas sold to it by Canadian at Clayton Junction; but he and the accounting witness who preceded him dealt with the two companies together, and "washed out" the cost between them at Clayton Junction. Furthermore, at no place in the Commission's Opinion are there any findings as to "fixed" costs, "variable" costs, "joint" costs, or any basic findings which disclose just what the Commission has done.

This failure to make appropriate findings in itself constitutes reversible error, *U.S. v. Carolina Freight Carriers Corporation*, 315 U.S. 475, 488-489, 86 L. Ed. 971. There this Court said:

> " * * * It is impossible to say that the standards which we have set forth were applied to the facts in this record. Hence, as in Florida v. United States, 282 U.S. 194, 215, 75 L. Ed. 291, 304, 51 S. Ct. 119, the defect is not merely one of the absence of a 'suitably complete statement' of the reasons for the decision; it is the 'lack of the basic or essential findings required to support the Commission's order.' And see United States v. Baltimore & O. R. Co., 293 U.S. 454, 464, 79 L. Ed. 587, 594, 55 S. Ct. 268; United States v. Chicago, M. St. P. & P. R. Co. 294 U.S. 499, 510, 511, 79 L. Ed. 1023. * * * Congress has prescribed statutory standards pursuant to which those rights are to be determined. Neither the Court nor the Commission is war-

ranted in departing from those standards because of any doubts which may exist as to the wisdom of following the course which Congress has chosen. Congress has also provided for judicial review as an additional assurance that its policies be executed. That review certainly entails an inquiry as to whether the Commission has employed those statutory standards. If that inquiry is halted at the threshold by reason of the fact that it is impossible to say whether or not those standards have been applied, then that review has indeed become a perfunctory process. * * * An insistence upon the findings which Congress has made basic and essential to the Commission's action is no intrusion into the administrative domain. It is no more and no less an insistence upon the observance of those standards which Congress has made 'prerequisite to the operation of its statutory command.' Opp Cotton Mills v. Administrator of Wage & Hour Division, 312 U.S. 126, 144, 85 L. Ed. 624, 635, 61 S. Ct. 524. Hence that requirement is not a mere formal one. Only when the statutory standards have been applied can the question be reached as to whether the findings are supported by evidence. * * *."

More recently, in *Interstate Commerce Commission, et al. v. Columbus and Greenville Railway Company*, 319 U.S. 551, 87 L. Ed. 1580, Mr. Justice Douglas in a concurring opinion referred to *United States v. Chicago, M. St. P. & P. R. Co.*, 294 U. S. 499, and stated:

"Mr. Justice Cardozo speaking for the Court stated in the latter case, 'We must know what a decision means before the duty becomes ours to say whether it is right or wrong.' 294 U.S. p. 511. That was said about another obscure and vague report of the Interstate Commerce Commission. We should say the same thing about the present report. The questions left unanswered by this report may be simple ones to experts. But we should have those answers before we put the imprimature of this Court on the Commission's order."

Such lack of findings, or such vague findings, are especially injurious to the petitioner in a case like the present. Here, the Commission is already exercising all of the functions, except that of judicial review. Once it was thought that

no one could be a judge in his own case. Under the currently prevailing system of administrative law, one and the same governmental entity, such as the Commission in this very case, frequently occupies and exercises the function of complainant, witness for the complainant, counsel for the complainant, and then decides the issues of fact, and, to the extent that such is necessary, the issues of law. Now, conceding to the Commissioners the very highest motives and integrity, such a system is inherently dangerous to parties whose rights are being so determined. The only function in the whole process that is not entrusted, in the final analysis, to the Commission is that of judicial review. If, in a case like the present, where the Printed Record is enormous, the making of basic findings is excused, or vague findings are tolerated, it will result in the nullification of any real judicial review, with the necessary result that from the beginning to the end, that is, from the filing of the complaint to the compulsion of the new rate, everything will be determined, in effect, by the same mind and the same functionary.

The rights of parties can only be protected by according to them full constitutional guaranties, and by an insistence upon a clear and explicit application of the statutory standards.

Despite the lack of appropriate findings we are, nevertheless, able to demonstrate at least the following errors in the Commission's method:

First, we know, as already demonstrated in the first part of our argument, that this method makes no separation, allocation or segregation of the plant and property of either company, separately or combined, (1) as between that devoted to intrastate and that devoted to interstate business, or (2) as between that used in selling gas for resale and that used for direct sales not subject to regulation. (R. V. 4, pp. 2317-2373.) When Lyon was asked about the intrastate market of Canadian in Texas, and the direct sales by Colorado Company to industries, which sales are not now subject to regulation, he stated:

"A. I have made no allocation, segregation of the property specifically devoted to the service of either of those markets." (R. V. 5, p. 2422.)

The failure of this Commission engineer to make any such separation of property was in obedience to the Commission's established practice to the effect that, as announced in its Opinion (R. V. 1, p. 175), no "allocation of physical property or portions thereon (sic)" need be made.

Secondly, we know beyond any doubt that the Commission's witness Lyon, in deriving these "costs," and in allocating them, ignored the priority and preferential use of the property which is granted to the regulated domestic and commercial gas as against the industrial business, both regulated and unregulated. The undisputed evidence shows that such priority and preference was made a matter of contract between all parties in interest, and was approved by the municipalities involved. Furthermore, the equally undisputed evidence is that this contractual provision has been scrupulously observed and carried out in practice. This evidence showed that within the period between July, 1932, and December 31, 1940, there had been forty interruptions in the service to direct sale industrial customers, due to high domestic peak loads or "freeze-ups" or washouts on the main line, and that these interruptions ranged in duration from five to 66 hours each. (R. V. 2, pp. 1026-1028.) Over this seven and one-half year period of time, records of which were introduced, the interruptions to the unregulated business averaged a little more than five occasions per annum; and, of course, it will be recognized that as the field pressures decline, the frequency and duration of such interruptions is bound to increase.

Despite this undisputed evidence, Lyon, in making his allocation, stated:

"During the year 1939 I have given no effect to any curtailment of service by reason of insufficient pipe line facilities. * * *." (R. V. 5, p. 2439.)

And again:

"A. * * * A dormant clause in a contract which is not exercised and may not be exercised for the life of the contract is a speculative matter." (R. V. 5, p. 2439.)

The exhibits of this Commission witness were prepared

and introduced, and his testimony given, in the face of the plain provision in all of the contracts and municipal franchises providing for preferential service to the regulated business, all of which had theretofore been introduced in evidence. Accordingly, there can be no excuse for the ignoring of these specific provisions. It is true that these exhibits, and this testimony on the part of the Commission, preceded the Company's testimony (undisputed) contained in Exhibit 290 (R. V. 2, pp. 1024-1030), showing the actual interruptions or curtailment of service to the unregulated business, because of priority and preferential service to the regulated business, resulting from various causes over the seven and one-half year period. The Commission's witness thereafter had full opportunity to amend his testimony and exhibits, but did not do so, and the Commission has accepted his testimony, and thus itself ignores these undisputed and vital facts.

As to this ignoring of the priority in the use of the plant and property accorded to the regulated business by contract and in practice as against the unregulated business, we quote the very excellent statement of the late Judge McDermott contained in his opinion in *Wichita Gas Co. v. Public Service Commission*, 3 Fed. Supp. 722. There, as Circuit Judge, he was sitting in the District Court for the District of Kansas in a suit by the Gas Company to enjoin the order of the Public Service Commission of the State of Kansas. One of the issues was the reasonableness of the 40-cent gate rate which the Gas Company was paying to another company. The Commission challenged the reasonableness of that rate by citing the fact that the same pipe line company sold gas to industrial consumers in and near Wichita for 20 cents. At page 725 Judge McDermott said:

> "The defendants' principal argument is that the supply company sells to industrial consumers and other purchasers, in and near Wichita, for 20 cents. The argument is faulty because it overlooks the load factor. The whole difficulty with domestic gas is that domestic users consume more gas in winter than in summer. The average domestic consumption in Wichita is 4,800 M per day. Yet on certain days, the domestic consumption runs to 40,000 M per

day. The domestic user needs his gas more on the cold days than the warm ones. The result is that enough gas must be produced or contracted for, and big enough lines built, to furnish 40,000 M per day. On 364 days, there is a surplus of gas and equipment. The plant is eight times too large for the average load; but it must be, or the people be short of gas when they need it most. Now the problem is, what is to be done with the surplus gas and surplus equipment? Is it better for all to make use of it, or let it lie idle? If it lies idle 360 days in the year, the loss is terrific; if surplus equipment and surplus gas is used in competition with coal, at a competitive price, whatever comes in from that source would look like clear gain. It appears to me that the net result of selling the surplus gas at 25 cents is to reduce the cost of gas to the domestic consumer. Some return is accruing from the otherwise idle equipment. I can see no fair comparison between selling surplus gas to an industry with an ordinarily constant load factor, reserving the right to shut off its gas at any moment, and the service of standing by ready to serve a domestic user with whatever he wants, from 30 feet a day in summer to 1,000 feet a day in winter. The situation is not unlike an ocean liner; it is built to carry 1,000 passengers; to carry them, it is necessary to build a ship that will carry ten times the weight of the passengers; the surplus capacity may be used for either ballast or freight. The passengers should not complain if freight is carried, although the rate per pound is much less than the rate per pound charged the passenger."

The evidence which we have already summarized and adverted to in this argument shows that in our case the line could not have been built had there not been both the direct sale and resale business available. The Commission in its Order, referring particularly to the contract with C. F. & I., states that its procurement was one of "the essential prerequisites of the ~~construction~~ of the * * * line." (R. V. 1, p. 142.) The willingness of these industrial customers to take the gas at a cheaper rate because of their inferior position, and their willingness to be "cut back" or "cut off" in cold weather, when the priority rights of the domestic customers

demanded the use of the line, made the building of the line possible. All parties in interest agreed to this. All customers understand it. The City of Denver approved it in its franchises and ordinances, as did Pueblo, and Colorado Springs recognized it in the contract it made with the Company for the supply of gas to its municipally-owned distribution system. Now the Commission chooses to ignore the inferior position of the non-regulable business by reason of these contract provisions, and enters an order that operates to shift costs from the regulable business to such non-regulable sales.

In the third place, we know that in the allocation of "transmission cost" the witness Lyon treated the entire transmission system as a unit, and as if it were one common conduit used by *all* the gas, and that he ignored the fact (1) that some laterals and metering stations and associated equipment are used exclusively in making direct sales to industrial customers, or the unregulated business; (2) that some laterals, metering stations and associated equipment are used exclusively in resale or regulated business; and (3) that the balance of the property is used in common *in varying degrees* by the regulated and unregulated business. Even in respect to the commonly used property he wholly ignored that the 20-inch diameter line north of Pueblo (as compared to the 22-inch diameter line south of Pueblo) is used almost exclusively by the regulated business. (R. V. 5, pp. 2427-2431.) These facts so ignored are also graphically represented on the Commission's own exhibit, 138, included as Appendix B to this brief.

Lyon's attention was directed to the fact that on this flow diagram map of the Commission it appeared that of the 21,594,112 Mcf of gas that was passed through the Bivins Station in 1939, 7,257,379 Mcf was sold directly to the C. F. & I. at Pueblo, and 1,676,091 Mcf was sold directly to Colorado Portland Cement, slightly north of Pueblo, and neither sale made any use whatever of the 105 miles of the 20-inch line north of those direct sales laterals.* Despite

*On the basis of use, the Company's engineer Rhodes assigned 99.48 per cent of this 20-inch line north of the Devine Station (Pueblo) to the resale or regulated business. (R. V. 4, p. 2271.)

these facts, Lyon went ahead and treated all of the transmission system, beginning with and including Canadian's Bivins compressor station in the field, and its transmission lines from that point in Texas, *together with all laterals used in making intrastate deliveries in Texas,* all of Colorado Interstate's transmission line to Denver, with all of its laterals, some of which, as just stated, were used exclusively in delivering direct sale gas, as a unit or common conduit and as if all the gas went in at the Bivins compressor, traversed the whole system, and came out at one common vent at the Denver city gate. (R. V. 5, pp. 2427-2431.) He admitted that in computing his "volumetric cost," a component of his total transmission cost, he so considered the system, and he gave no consideration to different segments of the line or the varying uses of the line in the regulated and unregulated business.

> "Q. So that as I say, the result of your method is to tend to increase your computed cost of gas that this pipe line sells to these industries for consumption and to correspondingly reduce that that goes all the way through the line and comes out at Denver?
>
> "A. I give no consideration as to whether the delivery is made to an industry or to a distribution plant or if it is resale gas or direct consumption. It is a factor, of course, under the method you have outlined that the farther the gas flows the more costs there are to accumulate. Under the method I have followed the geographical distribution of the load within that common cost zone is of no consequence." (R. V. 5, pp. 2429-2431.)

Under cross examination, he admitted that his method treats the 7,257,379 Mcf delivered to C. F. & I., the 1,676,091 Mcf delivered to Colorado Portland Cement, the 427,169 Mcf delivered to the Atchison, T. & S. F. Ry. Co., the 332,998 Mcf delivered to the American Crystal Sugar Company, and the other smaller deliveries to direct sale industrial customers in the Arkansas Valley, as if it used the Devine compressor station, and as if it used the 105-mile 20-inch diameter line northward to Denver, when in fact none of this direct sale gas ever used any part of that system. The necessary result of his treating the whole transmission system as a unit is wholly to

disregard the actual use of the property as between the regulated and unregulated business, and to "pile on" to this unregulated business large costs (included in his average cost), which the Company never incurred in the delivery of this unregulated gas. This method misstates the true cost which actually was incurred in delivering the regulated gas, particularly to Denver. (R. V. 5, pp. 2425, 2431, 2448.) See also the Commission's flow map, Appendix B to this brief. This fantastic ignoring of facts, of course, produced apparent, but not real, excess revenues from the regulated business, which the Commission used as an excuse for reducing the rates being charged for such sales.

In the fourth place, we know that as a part of such "costs" Lyon allowed and included a 6 per cent return (R. V. 5, p. 2409), which the Commission, however, in its Opinion increased to 6½ per cent (R. V. 1, p. 173) upon *all* of the property, including that used in the unregulated business as well as that in the regulated business. The effect of this was, of course, to derive a total cost, including such allowance for a "fair return" upon all the business, regulated *and unregulated,* which they then compared to the total revenues of the Company from all its business, regulated and unregulated, and thereby derived an "excess revenue" for the entire business. Whenever, in fact, a company is making a higher return on its unregulated business than is prescribed for the regulated, then this method of the Commission, whereby the limited return is first applied to *all of the property* in order to derive excess revenue from the whole business, operates to appropriate to the entire business the "excess" earnings from the unregulated part. Such method produces apparent "excess" earnings for the combined regulated and unregulated business. The Commission, in the instant case, purports to find that of such total earnings in excess of 6½ per cent on the *combined* business and property, \$131,000 of such "excess" (R. V. 1, p. 172) is allocable to the unregulated business. The Commission disclaims any right to order any reduction in prices for the unregulated business that would reflect a reduction of this \$131,000; *but the Commission overlooks the fact that there still lies concealed in the amount of reduction ordered for the regulated business "excess" earn-*

ings due to the imposition of this limitation of 6½ per cent on the whole business, regulated and unregulated. In another case, if the unregulated business was in fact being operated at less than 6½ per cent return on the property devoted to that business, or at a deficit, the Commission's method would in that case operate to appropriate excess earnings to the unregulated business, and thus obscure and conceal the true excess earnings on the regulated business.

The only way to assure that the regulated and unregulated business each "pays its own way" is to make a division of the property and expenses, as this Court has directed, and allow to the regulated business a fair return on the property so separated and allocated to it.

Lyon not only thus erroneously limited the return to petitioner upon property *exclusively* employed in unregulated business, but he imposed the same erroneous limitation of return upon an improper part or allocable portion of the jointly used property. This error will become more apparent hereinafter when we discuss the other errors committed by him in the allocation of "transmission costs." (R. V. 4, pp. 2333, line 25.) For the moment it is sufficient to point out that he divided his "transmission costs" into "volumetric costs" and "capacity costs." His "volumetric costs" have no relation to the property required for meeting the *maximum demands of the regulated business.* He included as a part of his total "transmission costs" a 6 per cent return on the property (which the Commission later increased to 6½ per cent), but he included only 50 per cent of such return in the "capacity cost" component of his "transmission costs." (R. V. 4, p. 2333, line 25.) In thus ignoring the true maximum demands of the regulated business, he departed completely from the requirements of a fair return on the *property* devoted to the public service. As a result of this device, costs that are truly assignable to the regulated business are shifted to the unregulated.

Even in those cases where the regulatory body has jurisdiction over all sales, and there is no combination of regulated and unregulated business, but only the problem of assigning costs as between several communities or regulated customers, the method used by Lyon has to hold that all

the return should be assigned to the capacity or demand costs. In *Arkansas-Louisiana Gas Company v. The City of Texarkana*, 96 Fed. (2d) 179, where the term "demand costs" is used synonymously with "capacity costs," the Circuit Court states:

"The demand costs include the operation and maintenance and general expense of the transmission pipe lines and compressor stations, depreciation on same, taxes, *the return on the value of the transmission system, together with the Federal and State income taxes on such return,* and the return on such part of working capital and going value as is properly apportioned to the value of the Transmission property." (Emphasis supplied.)

This arbitrary assignment of only 50 per cent of the return to the "capacity cost" component of the "transmission costs" magnifies the error inherent in the failure to separate the property devoted to the public service, and the computation of a proper return thereon separately considered.

In the fifth place, we know that in figuring hi transmission costs he gave no consideration to the fact that gas delivered to some customers had to be compressed more times and at greater expense than that delivered to other customers. His attention was again directed to the flow map (Appendix B to this brief), and the following colloquy took place:

"Q. I want to ask you with reference to this Exhibit No. 138 which was prepared by Mr. O'Connor, the flow chart showing where the gas comes in where it goes out—you are familiar with that?

"A. Yes, that is Mr. O'Connor's map.

"Q. Here is the delivery, say at Dalhart, Texas, which is a few miles away from Bivins. For every thousand cubic feet which is taken out of the line at Dalhart you apply that volumetric factor of three cents plus?

"A. Yes, I have.

"Q. So that for every thousand cubic feet of gas taken out at Denver you would again apply that three cents?

"A. That is correct." (R. V. 5, p. 2425.)

* * * * *

"Q. The fact that the gas going to Denver is compressed four times doesn't result in any greater charge against the gas delivered at Denver under your method than the gas that is compressed only once?

"A. That is correct." (R. V. 5, p. 2448.)

In the sixth place, we know that Lyon, in figuring his "capacity cost" component of his total transmission cost, ignored the obligation of petitioner to meet the peak load demands for the domestic gas that will occur on the coldest expected days, and that he arbitrarily took the deliveries of regulated and unregulated gas as they happened to occur on February 9, 1939, which he called the "system peak day" for that particular year. (R. V. 5, pp. 2434-2436; R. V. 4, p. 2319.)

The transmission cost, as allocated by him, was in part on a volumetric or average basis, which he called the "volumetric cost" component of his "transmission costs," and, as he candidly stated, he gave no effect to priority. In respect to his "capacity cost" component of his total transmission cost, he did depart from average or volume costs to the extent of separating such costs, *not upon the basis of a property separation, nor upon the basis of priority demand during the coldest weather to be expected,* but on the basis of deliveries to the regulated and unregulated business which happened to occur on his selected day. On the day selected by him the minimum temperature as shown by the Bulletin "U. S. Department of Commerce Weather Bureau, Monthly Meteorological Summary, Denver, Colorado, February, 1939" was minus 2, and the mean temperature for the day was 8°, Fahrenheit above zero. Out of all the years of operation from 1928 to 1939, inclusive, he took the warmest winter, 1939, save one, 1934, in the whole history of operations. He ignored, for example, that on February 8, 1936, the temperature in the Denver area was 25° below zero, and that in 1930 it was minus 20, and that the lowest *mean temperature* has reached minus 10 in 1933 and 1937, according to "U. S. Department of Commerce Weather Bureau, Annual Meteorological Summary, with Comparative Data, 1941, Denver, Colorado."

Rhodes, in his separation exhibit, studied the weather conditions during the whole history of the line, and, from actual conditions which had obtained during that period, showed that a 1 degree drop for one day in the temperature below 65° Fahrenheit, that is, a 1 degree day deficiency in temperature, increased the load of resale domestic gas by 660,000 cubic feet per day. (R. V. 2, pp. 1110, 1111.) He then showed that on the basis of the following temperatures that *had occurred*, the domestic load would be as follows:

		Mean Temperature On Coldest Day (Deg. F.)	Estimated Domestic Load On Such a Day (Cu. Ft.)
(a)	Denver Area	–14 deg.	42,157,000
(b)	Colorado-Wyoming Area	–20	10,775,000
(c)	Colorado Springs Area	–16	3,251,000
(d)	Pueblo Area	–10	2,230,000
(e)	Arkansas Valley Area	–10	1,304,000
(f)	New Mexico Area	– 6	531,000
(g)	Texas Area	– 6	1,483,000
	Total	–14.5 deg.	61,731,000

(R. V. 2, p. 1111.)

Lyon in his testimony stated that on his selected day of February 9, 1939, deliveries of resale gas at the Denver gate were 36,104 Mcf. This is to be compared with deliveries of 42,157 Mcf required when the mean temperature reaches 14° below zero. (R. V. 2, p. 1111.)

In his treatment of "capacity costs," the witness Lyon treated all industrial gas in one group, making no separation between that sold directly (unregulated) and that sold for resale (regulated). Then in spreading the "capacity costs" among the industrial gas deliveries, he used the individual maximum delivery whenever it occurred (R. V. 4, pp. 2319, col. 10; 2384), rather than the quantity delivered on the system's maximum day. (R. V. 4, p. 2319, col. 9.) This also served to reduce the costs assigned to the resale industrial gas.

On the day selected, i.e., February 9, 1939, for the pur-

pose of allocating "capacity costs," the mean temperature was 8 degrees above zero, far above the temperatures commonly experienced in the area, and to be expected in the future. The use of such day, therefore, was not representative. The undisputed testimony of petitioner already summarized showed that on January 24, 1940, when the mean temperature was only 1.5 degrees below zero, the regulated or resale gas amounted to 67,783 Mcf, and the unregulated gas was 47,343 Mcf. (R. V. 4, p. 2268.) This undisputed evidence also showed that by employing the factor derived from a study of the actual operation of the line during its whole history such actual peak day demands on any day could be translated into the relative demands that would exist on colder days. For example: when the mean temperature is 15 degrees below zero, then the regulated gas load would be 79,385 Mcf and the unregulated gas load 47,343 Mcf (R. V. 4, p. 2269), which represent the obligation of petitioner toward the respective classes of gas.

An exact comparison between the maximum obligation of petitioner with the testimony of Lyon is not possible because of the failure of Lyon to separate the resale gas from the direct sale gas. (R. V. 4, p. 2319, col. 8.) However, had Lyon apportioned his "capacity costs" on the basis of the relative load of regulated and unregulated gas on low temperature days actually experienced in the past operation of the line, a much larger percentage of such "capacity cost" component of the transmission cost would be assigned to the regulated business. We submit that the testimony of this Commission witness, Lyon, indicates that he set out deliberately to find one day in the seven and one-half year history of the Company's operation, which was far from the coldest day, but which, because of the relative low domestic load, would assign costs to the unregulated business. Such calculated testimony not only ignores the facts of nature and the evidence established in this record, but is palpably unfair.

The resale domestic customers, under the priority provisions of all contracts, are entitled to gas on the coldest expected day, and not on a day when the mean temperature is 8° above zero. The colder it is the more imperative is their demand, and their right to be served first. Yet Lyon

and the Commission would, in figuring this capacity cost component of transmission cost, make an allocation of cost as between the regulated and the unregulated business based on mere coincident deliveries on a day when the mean temperature was plus 8. Such action not only ignores realities, but is purely arbitrary and inexcusable.

Finally, we know that the Commission's method in its over-all effect produces results which are on their face arbitrary, unreasonable and inconsistent. In its announced costs for Colorado Interstate's customers (R. V. 1, p. 181), we find, for example, such cost to Citizens Utilities Company, at the city gate of La Junta, to be 24.3 cents per Mcf, whereas, the cost of delivering gas to Public Service Company at the city gate of Denver is only 15.4 cents per Mcf, despite the fact that such Denver gas has to be compressed once more than La Junta gas, and is transported approximately 145 miles farther than such La Junta gas. In arriving at such preposterous results, can it be said that the Commission is carrying out the statutory mandate and fixing a reasonable rate at each point? Their method wholly ignores the great disparity in the expense involved and the property devoted to the two services. Apparently the Commission, since deciding our case in March, 1942, has itself entertained some misgivings about the correctness of any such method, for in its decision No. 90, in Dockets Nos. G-133, 148, 157, 193 and 462, involving the rates of the *In Re United Gas Pipe Line Company*, handed down April 20, 1943, 48 PUR (NS) 91, 95, the Commission pointed out that there was considerable difference in the rates at the several city gates, and said:

> "This lower rate is due solely to the very close proximity of each of these areas to the sources of natural gas."

Each and all of the above specified errors in the Commission's allocation of costs directly operate to violate the jurisdictional limitations of the Natural Gas Act and to shift the cost from the regulated to the unregulated business, and, correspondingly, to inflate the apparent earnings from the regulated business. In *Smith v. Illinois Bell Telephone Co.*, supra, this Court stated:

resale to these communities in 1939, such sales constituting about eight-tenths of 1% of Canadian's 1939 sales (R. IV, 2319). Although petitioners allege that the Commission discriminated against these communities, they did not present any allocation showing the cost of rendering this service.[38] Therefore, the Commission staff's allocation is the only evidence in the record separating the cost of service for such intrastate sales. As the Commission commented in its opinion, "Nowhere in the entire evidence submitted by Canadian and Colorado Companies is there a complete presentation of the entire operations of the company broken down between jurisdictional and non-jurisdictional operations" (R. I, 175).

There is therefore no support in the record for petitioners' contention that the method employed by the Commission in allocating average transmission line costs to Dalhart, Hartley and Texline was improper or unfair. As above stated, the Denver pipe line would not have been built and the various communities along the route of the line would not be receiving the benefits of natural-gas service from the project were it not for the existence of the large markets at the end of the line in the vicinity of Denver. As the Commission engi-

[38] Petitioners' exhibits do not show the separate cost of these intrastate sales (Exh. 317; Tr. 24,332–38; Exh. 318, Tr. 24,354–58).

neer testified, it is not unreasonable to require all customers within a common "cost zone" to share equally in the cost of service from an integrated transmission line (R. IV, 2398). Cf. *Banton* v. *Belt Line Ry.*, 268 U. S. 413. Use of average costs in allocating transmission costs to customers served from a large integrated electric system has received the sanction ~~of this~~ Court. *Wabash Valley Electric Co.* v. *Young*, 287 U. S. 488, 499.

Canadian's contention that the Commission unfairly burdened its intrastate business by using the "average cost" method (Can. Br. 77–81) is refuted by the record. All of Canadian's intrastate sales are made to Amarillo Oil Company, principally at the wellhead in Texas, such sales constituting approximately 11% of Canadian's total annual sales volume (R. IV, 2319).[39] The revenues from these intrastate sales amounted to $205,000. The Commission assigned only $152,000 of costs to such sales, including a 6½% return, and found that Canadian is earning $53,000 in excess of a 6½% return on its intrastate business (R. I, 176). The Commission of course did not undertake to regulate such intrastate sales, and accordingly Canadian can retain the entire $53,000 of excess profit derived therefrom. There-

[39] Canadian's total intrastate sales to Amarillo Oil Company in 1939 amounted to 5,188,486 Mcf, of which 4,809,758 Mcf were sold at the wellhead and 378,912 Mcf were sold off the Denver line for resale to the towns of Dalhart, Hartley and Texline, Texas (R. IV, 2319).

fore the impact of the Commission's order could hardly be said to constitute an undue burden on Canadian's intrastate business.

Colorado Interstate further contends that the Commission's action was arbitrary in assigning 50% of the return to the "capacity cost" component of the "transmission costs" and 50% to the "volumetric cost" component (Col. Br. 48–49). The method used by the Commission is supported by substantial evidence and was reasonable (R. V, 2424–2425). If, as the Company contends, the entire return on the transmission facilities should be apportioned to "capacity costs" and none to "volumetric costs" absurd results would follow. Under such method, a direct industrial customer taking substantial quantities of gas every day throughout the year except on the single peak day would not be charged with any of the return on the transmission line facilities. Thus, such industrial customer would to that extent obtain free transportation from the line for an entire year, although he makes substantial use of the line 364 days of the year.

3. *System Peak Day.*—Colorado Interstate also contends that the Commission "arbitrarily" allocated the "capacity cost" component of the transmission costs on the basis of deliveries on February 9, 1939, the system peak day for that particular year when the mean temperature was 8° Fahrenheit; that this was the warmest winter in

the whole history of operations, except for the winter of 1934; and that the Commission engineer "set out deliberately to find one day in the seven and one-half year history of the Company's operation, which was far from the coldest day, but which, because of the relatively low domestic load, would assign costs to the unregulated business" (Col. Br. 50–53). The Company urges that the Commission should have used either January 24, 1940, when the mean temperature was 1.5° below zero, or a hypothetical peak day which assumes deliveries on the basis of a mean temperature of 15° below zero (Col. Br. 51–52). However, the adoption of either contention would result in assessing more costs to the direct industrial customers than were assigned by the Commission.

The Commission used the deliveries on February 9, 1939, as the basis of allocating capacity costs because it was admittedly the day of system peak deliveries in the test year 1939 (R. V, 2434). Obviously, it was appropriate to stay within the test year in allocating 1939 costs. The total deliveries on February 9, 1939, were 94,998 Mcf, of which 35,425 Mcf, or 37%, was sold to direct industrial customers and 59,573 Mcf, or 63%, was sold to wholesale customers. Accordingly, the Commission allocated 37% of the capacity costs to the direct industrial customers and 63% to the wholesale customers (R. IV, 2319, 2317). On January 24, 1940, when the mean temperature was

1.5° below zero, the sales to direct industrial customers amounted to 47,343 Mcf, or 41%, and the sales to wholesale customers amounted to 67,783 Mcf, or 59% (Col. Br. 52). If, as the company urges, the Commission had used the deliveries on January 24, 1940, 41% instead of 37% of the capacity costs would have been assigned to the direct industrial customers. Similarly, the use of petitioners' calculated deliveries on their proposed hypothetical peak day, which assumes a 15° below zero mean temperature, would produce a more harmful result to petitioners than the use of the actual peak-day deliveries in 1939 adopted by the Commission. Petitioners' witness, Rhodes, testified that the "maximum day obligation ratio based on total peak-load obligations" for such hypothetical peak day would be 38.2% for the direct industrial customers and 61.8% for the wholesale customers (R. IV, 2269). Thus, the use of the hypothetical peak day would result in assigning 38.2% of the capacity costs to the direct industrial customers instead of the 37% assigned by the Commission.

Colorado Interstate's contention that the Commission's allocation results in discrimination between gas sold to Citizens Utilities Company for resale at La Junta, Colorado, and gas sold to Public Service Company for sale in the city of Denver (Col. Br. 53), is not well taken. The Commission did not prescribe specific rate schedules for these

sales nor for any other sales, but ordered a reduction in Colorado's interstate wholesale rates in the aggregate amount of $2,065,000 (R. I, 191). The further rate-making step of prescribing specific rate schedules for sales at the various delivery points is yet to be taken. See *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575, 584–585.[40]

4. *Adequacy of Findings.*—Petitioners also contend (Col. Br. 38–41; Can. Br. 76) that the Com-

[40] It may be noted that the difference in the cost to serve Public Service Company of Colorado (Denver and environs) and Citizens Utilities Company (La Junta and seven other small communities) is not due to any erroneous determination of transmission costs, nor to a fallacious allocation method, as implied by Colorado, but is caused primarily by the difference in distribution costs. Sales to Public Service Company by Colorado were 49 times as great as to Citizens Utilities Company in 1939 (R. IV, 2319), and hence average distribution costs per Mcf incurred by Colorado Company in delivering gas to Denver and environs was only a fraction of the average distribution cost per Mcf incurred in delivering gas to Citizens Utilities Company for resale at La Junta and seven other small communities. Reference to the staff engineer's exhibit (R. IV, 2317) and to Appendix B, Schedule 4, of this brief shows that the Commission found that distribution costs incurred in serving Public Service Company of Colorado were $38,412 or 0.6¢ per Mcf sold to that company. Distribution costs in serving Citizens Utilities Company were $16,861 or 9.3¢ per Mcf. Therefore, excluding distribution costs, the cost of serving Public Service Company of Colorado averaged 14.8¢ per Mcf and the cost to serve Citizens Utilities Company was 15.0¢ per Mcf, or the two costs were the same for practical purposes.

mission failed to make appropriate findings with respect to its allocation. However, Canadian admits (Can. Br. 81) that "it is clear from the Commission's opinion that it had adopted the allocation methods and principles of Commission witnesses and * * * base[d] its rate reduction order thereon." As appears from its opinion (R. I, 174–177) the Commission adopted the method presented by its staff engineer but used its revised and higher total cost of service in the allocation (R. I, 176). The application of the staff's allocation to such total cost of service was merely a mathematical calculation (See Appendix B, *infra*).[41]

We accordingly submit that the allocation made by the Commission is based upon competent evidence and has a rational basis. Neither the Act nor the Constitution requires more.

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[41] That petitioners clearly understand how the final figures were derived is apparent from Canadian's brief (pp. 81–82) where it states that the source of the cost-of-service figure of $1,575,000 for gas sold by Canadian to Colorado in the Commission's opinion is "self-evident." As stated in Canadian's brief (p. 82), the method followed by the Commission in arriving at the separate cost of service for gas sold by Canadian to Colorado was to deduct from Canadian's total actual costs ($1,770,000) the allocated cost of service to all Canadian's customers except Colorado ($195,000), thereby securing the cost of service of gas to Colorado ($1,575,000) (R. I, 176).

V

ALL OF CANADIAN'S SALES TO COLORADO INTERSTATE, BEING SALES FOR RESALE IN INTERSTATE COMMERCE, ARE SUBJECT TO REGULATION BY THE COMMISSION

Canadian contends (Br. 83–87) that the Commission, in regulating the rate charged by Canadian for *all* the gas sold to Colorado Interstate, exceeded its jurisdiction under the Act, adverting to the fact that approximately one-half of such gas is sold by Colorado Interstate directly to industrial customers. Since the Commission cannot prescribe the rates which Colorado Interstate charges such direct industrial customers, Canadian contends that the Commission has no jurisdiction to regulate Canadian's charges to Colorado Interstate for such gas and that the ordered reduction in Canadian's rate to Colorado Interstate, to that extent, constituted "a foolish and vain exercise of rate regulatory jurisdiction" (Can. Br. 87). We submit that these contentions lack merit.

As the provisions of the Act and its legislative history make clear, all of the gas which Canadian sells to Colorado Interstate is sold to Colorado Interstate for resale by the latter and is therefore subject to the Commission's jurisdiction under the Act. Section 1 (b) of the Act specifically provides that the provisions of the Act "shall apply

to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use * * *." Accordingly, by the express terms of the statute, all of the gas sold by Canadian to Colorado, including that sold for resale "for industrial" use, is subject to rate regulation by the Commission.

Any ambiguity by reason of the reference in Section 1 (b) to resale "for ultimate public consumption" is resolved by an examination of the legislative history. As originally introduced, the bill (H. R. 4008, 75th Cong., 1st Sess.) which as amended (H. R. 6586, 75th Cong., 1st Sess.) became the Natural Gas Act, contained the following language in Section 1 (b):

> "(b) The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale of such natural gas for resale *to the public,* and to natural-gas companies engaged in such transportation or sale, but shall not apply to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas: *Provided,* That nothing in this Act shall be construed to authorize the Commission to fix the rates or charges to the public

> for the sale of natural gas distributed locally or for the sale of natural gas for industrial use only." [Emphasis supplied.]

In the hearings before the House Committee on Interstate and Foreign Commerce with respect to H. R. 4008, Mr. John E. Benton, the General Solicitor of the National Association of Railroad and Utility Commissioners, suggested among other amendments that the phrase "to the public" be deleted from Section 1 (b). He explained that the purpose of this amendment was (Hearings, pp. 21–22):

> "* * * to make certain that the bill will apply to all intercompany sales of natural gas at wholesale, even though the sale be from one company to another company which will resell to another corporation before the gas is finally sold to the public."

Later in the hearings, Mr. William A. Dougherty (see pp. 25–26, *supra*) proposed an amendment to Section 1 (b), to add at the end of the section: "or for resale for industrial use only" (Hearings, pp. 123–124). The obvious purpose of this suggestion, as explained by Mr. Dougherty (Hearings, p. 125), was to exclude "the gas that the pipe line sells to the distributing company for resale for industrial purposes," and "to make clear that all gas that ultimately goes to industrial customers, purchased under the separate rate or a separate contract, for that pur-

pose is not within the provisions of this legislation." [42]

With reference to Mr. Benton's proposal to delete the words "to the public" from Section 1 (b), Mr. Dougherty stated that while he realized the reasons for Mr. Benton's amendment, he felt that the Committee should consider inserting the words "for ultimate public consumption" in lieu of the words "to the public". Mr. Dougherty stated that the reason for his suggestion in this regard was (Hearings, p. 130):

> "So that it is clear even though there *your* [are] successive sales of gas, all of which are subject to the Commission's jurisdiction, that the gas ultimately must be distributed for general public consumption before there is any right to fix the rates, so that we get no problem of indirect industrial sales that might perchance on their face be under this Commission's jurisdiction."

In objecting to this amendment suggested by Mr. Dougherty, Mr. Benton by letter to the Committee of March 29, 1937, suggested the lan-

[42] In response to an inquiry from Representative Martin, Mr. Dougherty stated that there was "a considerable volume of that character of resale" and that "most of it" is sold in that way. By way of example, Mr. Dougherty stated that Colorado Interstate Gas Company sells direct to Colorado Fuel & Iron Company, "a tremendously large consumer," but in Denver "all of the industries are sold gas by the local company, the gas being purchased from the pipe line company."

guage which was substantially adopted by the Committee, and in so doing Mr. Benton stated (Hearings, pp. 142-143):

> "Sales for industrial use ought not to be exempt from all regulation, for the result may very well be that unjustifiable discrimination will result, and there will be no commission to which complaint may be made. Sales for industrial uses plainly ought to be subject to regulation by the same Commission which regulates sales to other classes of consumers, so that just and reasonable rates, for the several classes of service, properly related to each other, may be established. Under the bill as drawn, all consumer sales are exempt from Federal regulation, and left to State regulation. The language of the suggested amendment just proposed leaves this purpose unaffected, and makes clear that the regulation of intercompany sales is designed for the protection of the consuming public, as a part of the complete regulation of the entire utility service."

It is thus clear from the legislative history that under Section 1 (b) all the gas which Canadian sells to Colorado Interstate, including that which Colorado Interstate sells directly to industrial customers, is subject to regulation by the Commission.

In its brief (p. 86) Canadian contends that since under the proviso in Section 4 (e) of the Act the Commission has no authority to suspend

the rates charged for the sale of natural gas "for resale for industrial use only," such rates are not subject to regulation by the Commission. However, if the Commission had no authority to regulate the rates charged for gas sold for resale for industrial use, the proviso in Section 4 (e) exempting such rates from the suspension power of the Commission would be meaningless, since the Commission's authority to suspend rates is limited to those rates which are subject to its jurisdiction. Moreover, all the gas which Canadian sells to Colorado Interstate is sold under a single rate without distinction between the gas which Colorado Interstate may sell directly to industrial customers and that which it sells to various distributing companies for resale. Accordingly there is only one rate between Canadian and Colorado Interstate, and it is not a rate covering the sale of gas for resale "for industrial use only."

Canadian also contends that since the Commission for purposes of allocation treated Canadian and Colorado Interstate as an integrated system, it should have limited its rate reduction to those rates over which it would have jurisdiction if Canadian and Colorado Interstate were in fact one company, in which event there would not be any sale or rate between Canadian and Colorado Interstate and the sales which the latter makes directly to industrial consumers, not being for resale, would not be subject to the Commission's

jurisdiction. While, as above stated, the Commission properly treated Canadian and Colorado Interstate as a unit for purposes of its allocation of cost of service, it does not follow that the Commission's rate order in respect of Canadian is invalid.

In considering the rationale and purposes of these proceedings, the matter should be approached from the standpoint of the ultimate consumer in the various cities, including Denver and Pueblo, which receive their supply of gas from this pipe line. The rates charged such consumers by the local distributing companies in those cities are subject to State regulation, but the reasonableness of such "burner tip" rates is principally dependent upon the price which the distributing company pays to Colorado Interstate for the gas at the city gates. The purchase price of the gas is claimed by the distributing company as an operating expense in any State proceeding involving the reasonableness of the retail rates and that price, being an interstate wholesale rate, cannot be regulated by the state commission (*Missouri* v. *Kansas Gas Co.*, 265 U. S. 298).

The instant proceedings were commenced when the City and County of Denver filed complaints with the Federal Power Commission alleging that the "gate" rates being charged the distributing company in that city by Colorado Interstate were unreasonable, and requesting the Commis-

sion to determine and fix the reasonable rate. Since the reasonableness of Colorado Interstate's city gate rates was in large part dependent upon the reasonableness and propriety of the price which Colorado Interstate pays to Canadian River for gas, the principal operating expense of Colorado Interstate, the Commission had to determine the reasonableness of the rate between Canadian and Colorado Interstate. The Commission, after hearing, determined that such rate was unreasonable to the extent of $551,000 and that therefore the amount claimed by Colorado Interstate as an operating expense for cost of purchased gas should be reduced to that extent in determining the reasonableness of Colorado Interstate's city gate rates.

The Commission under the statute accordingly required Canadian to reduce its charges to Colorado Interstate. It might be urged in this connection that the Commission could have merely disregarded the corporate entities and in fixing Colorado Interstate's rates reduced its claim for the cost of purchased gas to the extent of $551,000, without making any change in the rate being charged to Colorado Interstate by Canadian. However, this rate, being for the sale of gas in interstate commerce for resale, was embodied in a rate schedule filed by Canadian with the Commission as required by Section 4 of the Act, which prohibits a natural-gas company from charging

any rate for a sale subject to the Commission's jurisdiction except in accordance with a filed rate schedule.[43] Accordingly, unless and until the filed rate between Canadian and Colorado Interstate has been changed by order of the Commission or by the filing of a new rate schedule, Canadian would have to charge Colorado and Colorado would have to pay the original rate, including the excess of $551,000 which the Commission found to be unreasonable. To have limited the allowance in Colorado Interstate's operating expenses to what the Commission had determined to be a reasonable charge by Canadian for the gas sold to Colorado Interstate, without complying with the statutory requirements necessary to relieve Colorado Interstate from the obligation of paying the excess of $551,000 to Canadian, would probably have resulted in a direct confiscation in the case of Colorado Interstate to that extent. Moreover, under the Act it is the Commission's duty when it has found an existing rate to be unreasonable to require a reduction in such rate.

We therefore submit that the Commission did not exceed its jurisdiction when it required a reduction in the interstate wholesale rate being charged Colorado Interstate by Canadian to the extent found unreasonable.

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[43] A violation of this section would carry the possibility of criminal and civil penalties.

CONCLUSION

For the reasons stated, it is respectfully submitted that the decision below should be affirmed.

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APPENDIX A

The pertinent provisions of the Natural Gas Act of 1938, c. 556, 52 Stat. 821 (15 U. S. C. § 717 *et seq.*), as amended by the Act of February 7, 1942 (56 Stat. 83), are as follows:

SECTION 1. (a) As disclosed in reports of the Federal Trade Commission made pursuant to Senate Resolution 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.

(b) The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

SEC. 4. (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this Act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate,

charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, or State commission, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect: *Provided*, That the Commission shall not have authority to suspend the rate, charge, classification, or service for the

sale of natural gas for resale for industrial use only; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing

company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

SEC. 6. (a) The Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making pur-

poses, other facts which bear on the determination of such cost or depreciation and the fair value of such property.

(b) Every natural-gas company upon request shall file with the Commission an inventory of all or any part of its property and a statement of the original cost thereof, and shall keep the Commission informed regarding the cost of all additions, betterments, extensions, and new construction.

SEC. 7. (c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however,* That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on the effective date of this amendatory Act, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after the effective date of this amendatory Act. Pending the determination of

any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however,* That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(e) Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public con-

venience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

(f) The Commission, after a hearing had upon its own motion or upon application, may determine the service area to which each authorization under this section is to be limited. Within such service area as determined by the Commission a natural-gas company may enlarge or extend its facilities for the purpose of supplying increased market demands in such service area without further authorization.

(g) Nothing contained in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural-gas company.

SEC. 8. (a) Every natural-gas company shall make, keep, and preserve for such periods, such accounts, records of cost-accounting procedures, correspondence, memoranda, papers, books, and other records as the Commission may by rules and regulations prescribe as necessary or appropriate for purposes of the administration of this act: *Provided, however,* That nothing in this act shall relieve any such natural-gas company from keeping any accounts, memoranda, or records which such natural-gas company may be required to keep by or under authority of the laws of any State. The Commission may prescribe a system of accounts to be kept by such natural-gas companies, and may classify

such natural-gas companies and prescribe a system of accounts for each class. The Commission, after notice and opportunity for hearing, may determine by order the accounts in which particular outlays or receipts shall be entered, charged, or credited. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry, and the Commission may suspend a charge or credit pending submission of satisfactory proof in support thereof.

(b) The Commission shall at all times have access to and the right to inspect and examine all accounts, records, and memoranda of natural-gas companies; and it shall be the duty of such natural-gas companies to furnish to the Commission, within such reasonable time as the Commission may order, any information with respect thereto which the Commission may by order require, including copies of maps, contracts, reports of engineers, and other data, records, and papers, and to grant to all agents of the Commission free access to its property and its accounts, records, and memoranda when requested so to do. No member, officer, or employee of the Commission shall divulge any fact or information which may come to his knowledge during the course of examination of books, records, data, or accounts, except insofar as he may be directed by the Commission or by a court.

(c) The books, accounts, memoranda, and records of any person who controls directly or indirectly a natural-gas company subject to the jurisdiction of the Commission and of any other company controlled

by such person, insofar as they relate to transactions with or the business of such natural-gas company, shall be subject to examination on the order of the Commission.

SEC. 9. (a) The Commission may, after hearing, require natural-gas companies to carry proper and adequate depreciation and amortization accounts in accordance with such rules, regulations, and forms of accounts as the Commission may prescribe. The Commission may from time to time ascertain and determine, and by order fix, the proper and adequate rates of depreciation and amortization of the several classes of property of each natural-gas company used or useful in the production, transportation, or sale of natural gas. Each natural-gas company shall conform its depreciation and amortization accounts to the rates so ascertained, determined, and fixed. No natural-gas company subject to the jurisdiction of the Commission shall charge to operating expenses any depreciation or amortization charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation or amortization other than that prescribed therefor by the Commission. No such natural-gas company shall in any case include in any form under its operating or other expenses and depreciation, amortization, or other charge or expenditure included elsewhere as a depreciation or amortization charge or otherwise under its operating or other expenses. Nothing in this section shall limit the power of a State commission to determine in the exercise of its jurisdiction, with respect to any natural-gas company, the percentage rates of de-

preciation or amortization to be allowed, as to any class of property of such natural-gas company, or the composite depreciation or amortization rate, for the purpose of determining rates or charges.

(b) The Commission, before prescribing any rules or requirements as to accounts, records, or memoranda, or as to depreciation or amortization rates, shall notify each State commission having jurisdiction with respect to any natural-gas company involved and shall give reasonable opportunity to each such commission to present its views and shall receive and consider such views and recommendations.

SEC. 10. (a) Every natural-gas company shall file with the Commission such annual and other periodic or special reports as the Commission may by rules and regulations or order prescribe as necessary or appropriate to assist the Commission in the proper administration of this act. The Commission may prescribe the manner and form in which such reports shall be made, and require from such natural-gas companies specific answers to all questions upon which the Commission may need information. The Commission may require that such reports shall include, among other things, full information as to assets and liabilities, capitalization, investment and reduction thereof, gross receipts, interest due and paid, depreciation, amortization, and other reserves, cost of facilities, cost of maintenance and operation of facilities for the production, transportation, or sale of natural gas, cost of renewal and replacement of such facilities, transportation, delivery, use, and sale of natural gas. The Commission may require any such natural-gas company to make adequate provision

for currently determining such costs and other facts. Such reports shall be made under oath unless the Commission otherwise specifies.

(b) It shall be unlawful for any natural-gas company wilfully to hinder, delay, or obstruct the making, filing, or keeping of any information, document, report, memorandum, record, or account required to be made, filed, or kept under this act or any rule, regulation, or order thereunder.

SEC. 11. (a) In case two or more States propose to the Congress compacts dealing with the conservation, production, transportation, or distribution of natural gas it shall be the duty of the Commission to assemble pertinent information relative to the matters covered in any such proposed compact, to make public and to report to the Congress information so obtained, together with such recommendations for further legislation as may appear to be appropriate or necessary to carry out the purposes of such proposed compact and to aid in the conservation of natural-gas resources within the United States and in the orderly, equitable, and economic production, transportation, and distribution of natural gas.

(b) It shall be the duty of the Commission to assemble and keep current pertinent information relative to the effect and operation of any compact between two or more States heretofore or hereafter approved by the Congress, to make such information public, and to report to the Congress, from time to time, the information so obtained, together with such recommendations as may appear to be appropriate or necessary to promote the purposes of such compact.

SEC. 14. (b) The Commission may, after hearing, determine the adequacy or inadequacy of the gas reserves held or controlled by any natural-gas company, or by anyone on its behalf, including its owned or leased properties or royalty contracts; and may also, after hearing, determine the propriety and reasonableness of the inclusion in operating expenses, capital, or surplus of all delay rentals or other forms of rental or compensation for unoperated lands and leases. For the purpose of such determinations, the Commission may require any natural-gas company to file with the Commission true copies of all its lease and royalty agreements with respect to such gas reserves.

SEC. 16. The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this act. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this act; and may prescribe the form or forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after publication in the manner which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission shall prescribe. For the purposes of its rules and regulations, the Commission may classify persons and matters within its

jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours.

SEC. 19. (a) Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this act to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon.

(b) Any party to a proceeding under this act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a writ-

ten petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting

aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347).

(c) The filing of an application for rehearing under subsection (a) shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

U. S. GOVERNMENT PRINTING OFFICE: 1945

APPENDIX B

SCHEDULE 1

Canadian River Gas Company
Adjustments Made by Commission in Staff's Cost of Servi[illegible]xh. 226)
and Allocation Thereof to Functional Divisi[illegible]

Line	Description (1)	Amount (2)	Classification (3)	Adjustments Allocated to Functional Divisions: Cost of Gas At Well-head (4)	Cost of Ga[illegible]ering (5)	Residuals Refining Cost (6)	Transmission Cost: Volumetric (7)	Transmission Cost: Capacity (8)
1	Additional Expenses Allowed							
2	Production Expense	$ 11,722	Residuals	$ -	$[illegible]	$ 11,722	$ -	$ -
3	General Expense (Rate Case Expense)	1/ 41,000	General	19,569	[illegible]10	4,174	-	15,847
4	Depreciation of General Plant	2/ 3,787	"	2,034	[illegible]71	108	-	1,174
5	Depletion	36,104	Well-head	36,104	[illegible]	-	-	-
6	Federal Capital Stock Tax	2/ 2,021	General	1,086	[illegible]51	57	-	627
7	Delay Rentals	(6,614)	Well-head	(6,614)	[illegible]	-	-	-
8	Total Additional Expenses	$ 88,020		$ 52,179	$[illegible]32	$ 16,061	-	$17,648
9	Additional Return on Rate Base Allowed							
10	Leaseholds and Well Facilities	$ 67,473	Well-head	$ 67,473	$[illegible]	$ -	$ -	$ -
11	Gathering Facilities	6,496	Gathering	-	[illegible]96	-	-	-
12	Gasoline Plant	1,481	Residuals	-	[illegible]	1,481	-	-
13	Transmission Plant	33,065	Transmission	-	[illegible]	-	$16,532	16,533
14	General and Undistributed Plant	2/ 10,289	General	5,587	[illegible]80	292	1,595	1,595
15	Total Additional Return	$118,804		$ 73,000	$[illegible]76	$ 1,773	$18,127	$18,128
16	Total Additional Cost of Service Allowed	$206,824		$125,179	$[illegible]08	$ 17,834	$18,127	$35,776

1/ **Allocation of Administrative and General Expenses**

First Allocation: Between Production and Transmission on basis of total direct expenses.

	Direct Expenses	%
Production (exclud. residuals credit)	$510,984.60	61.35
Transmission	321,869.98	38.65
Total	$832,854.58	100.00

Second Allocation: Allocation of Production Portion to Well-head, Gathering and Residuals on basis of operation and maintenance expenses, Tables 5, 6 and 7 of Exh. 226.

	Basis	%
Well-head	$391,153.40	77.8
Gathering	28,012.89	5.6
Residuals Refining	83,570.90	16.6
Total	$502,737.19	100.0

[illegible]omposite Resu[illegible]f Both Allocations

Well-head[illegible]	77.8 x 61.35 =	47.73%
Gathering[illegible]	5.6 x 61.35 =	3.44
Residuals[illegible]	16.6 x 61.35 =	10.18
Subtota[illegible]		61.35
Transmiss[illegible]		38.65
Total		100.00%

Administrative[illegible] General Expense So Allocated
Rate Case Ex[illegible]se $41,000

Well-head	$19,569
Gathering	1,410
Residuals	4,174
Subtota[illegible]	$25,153
Transmiss[illegible]	15,847
Total	$41,000

2/ **Allocation of General and Undistributed Plant Expenses**

Basis: Net Book Cost of Plant in Service 12/31/39

	Basis	%	Depreciation of Gen. and Undistr. Plant	Federal Capital Stock Tax	Return on General [illegible]d Undistr. P[illegible]t
Well-head(Leases,Wells,etc.)	$4,496,351	53.72	$ 2,034	$ 1,086	$ 5,5[illegible]
Gathering	1,041,004	12.44	471	251	1,2[illegible]
Residuals	237,224	2.84	108	57	29[illegible]
Subtotal	$5,774,579	69.00	$ 2,613	$ 1,394	$ 7,09[illegible]
Transmission	2,595,027	31.00	1,174	627	3,190
Total	$8,369,606	100.00	$ 3,787	$ 2,021	$10,2[illegible]

APPENDIX B (CONTINUED)

SCHEDULE 2

Colorado Interstate Gas Company
Adjustments made by Commission in Staff's Cost of Ser (Exh.226)
and Allocation Thereof to Functional Divis

Line	Description (1)	Amount (2)	Classification (3)	Adjustments as Alloted to Functional Divisions — Transmission Costs — Volume (4)	Transmission Costs — Capacity (5)	Distribution Costs (6)
1	Additional Expenses					
2	Rate Case Expense	1/ $ 43,000	General		$ 36,249	$ 6,751
3	Other General Expense	1/ 887	General		748	139
4	Transmission Maintenance	7,360	Transmission		7,360	
5	Transmission Maintenance	(668)	Transmission		(668)	
6	Depreciation of Trans. Plant	368	Transmission		368	
7	Depreciation of General Plant	2/1,552	General		1,531	21
8	Amortization	1/13,890	General		11,709	2,181
9	Federal Capital Stock Tax	2/22,694	General		22,383	311
10	Total additional exp.	$89,083			$79,680	$9,403
11	Additional Return on Rate Base Allowed					
12	Transmission Plant	$ 59,172	Transmission	$29,5	$29,586	
13	Distribution Plant	544	Distribution			$ 544
14	General Plant	2/13,722	General	6,7	6,767	188
15	Total Additional Return	$ 73,438		$36,3	$36,353	$ 732
16	Total Additional Cost of Service Allowed	$162,521		$36,3	$116,033	$10,135

1/ These additional costs are allocated between transmission and distributi on basis of Colorado's transmission and distribution expenses, as shown in Exhibit 140, p. 103, ine 23, col. 5 ($277,246) and p. 104, line 37, col. 5 ($50,992).

2/ These items allocated on basis of net plant in service December 31, 1939 in accordance with method employed in Exhibit 226.

The allocations between volumetric and capacity costs follow the method used in Exhibit 226.

APPENDIX B (CONTINUED)

SCHEDULE 3

Canadian River Gas Company and Colorado Interstate Gas Company
Summary of Adjustments Made by Commission in Transmission Costs and
Allocation of Transmission Capacity Costs

Company	Transmission Costs			
			Allocation of Capacity Costs	
	Volumetric Costs	Capacity Costs	Domestic, Commercial and Gas Lost	Industrial
Canadian Company (Sched.1)	$18,127	$ 35,776		
Colorado Company (Sched.2)	36,353	116,033		
Total	$54,480	$151,809	$68,188	$83,621

Note: Allocation between domestic, commercial and gas lost and industrial in accordance with method employed in Exhibit 226.

APPENDIX B (CONTINUED)

SCHEDULE 4

Canadian River Gas Company and Colorado Interstate Gas Company
Adjustments Made by Commission in Cost of Service Shown in Staff Exh. 226

Line	Customer	Annual Gas Volumes MCF 1/	Cost of Service Per Staff Exhibit 226	COMMISSION ADJUSTMENTS 2/ Well-Head Costs	Gathering Costs	Residuals Refining Costs	Transmission Costs: Volumetric Costs	Transmission Costs: Capacity Costs: Domestic, Commercial and Gas Lost	Transmission Costs: Capacity Costs: Industrial	Distribution Costs	Total Adjustments	Total Cost of Service As Adjusted	As Rounded Out by Commission
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
1	Sales from Transmission System												
2	Direct Sales by Colorado Co.												
3	Sales to Direct Industrial Customers	9,693,637	$1,047,888	$25,333	$ 2,229	$ 2,714	$ 24,193	$ -	$ 55,608	$ 1,723	$111,300	$1,159,688	$1,162,000
4	Sales to Public Authorities (U.S. Govt)	212,808	29,457	556	49	60	531	1,633	-	274	3,103	32,560	33,000
5	Total	9,906,445	$1,077,345	$25,889	$ 2,278	$ 2,774	$ 24,724	$ 1,633	$ 55,608	$ 1,997	$114,903	$1,192,248	$1,195,000
6	Sales for Resale by Colorado Co.												
7	Arkansas Valley Natural Gas Co. 3/	15,564	$ 3,247	$ 41	$ 4	$ 4	$ 39	$ -	$ 116	$ 111	$ 315	$ 3,562	$ 3,000
8	Citizens Utilities Co.	181,017	39,675	473	42	51	452	1,256	335	1,439	4,048	43,723	44,000
9	City of Colorado Springs	805,981	96,822	2,106	185	226	2,012	3,450	1,738	659	10,376	107,198	107,000
10	Colorado-Wyoming Gas Co.	2,867,649	357,652	7,494	659	803	7,157	11,876	10,160	182	38,331	395,983	397,000
11	Pueblo Gas and Fuel Co.	452,992	66,197	1,184	104	127	1,130	2,546	746	1,470	7,307	73,504	74,000
12	Public Service Co. of Colorado	6,650,953	927,919	17,381	1,529	1,862	16,599	45,611	13,149	4,277	100,408	1,028,327	1,027,000
13	Total	10,974,156	$1,491,512	$28,679	$ 2,523	$ 3,073	$ 27,389	$ 64,739	$ 26,244	$ 8,138	$160,785	$1,652,297	$1,652,000
14	Sales for Resale by Canadian Co.												
15	Clayton Gas Co.	104,710	$ 13,259	$ 274	$ 24	$ 29	$ 261	$ 534	$ 301	$ -	$ 1,423	$ 14,682	$ 15,000
16	Amarillo Oil Co. (from Denver Pipe Line)	378,912	45,559	990	87	106	946	1,282	1,468	-	4,879	50,438	4/
17	Total	483,622	$ 58,818	$ 1,264	$ 111	$ 135	$ 1,207	$ 1,816	$ 1,769	-	$ 6,302	$ 65,120	$ 15,000
18	Gas Used in Company Operations												
19	Colorado Co.	226,495	$ 12,488	$ 592	$ 52	$ 63	$ 565	$ -	$ -	$ -	$ 1,272	$ 13,760	$ 14,000
20	Canadian Co.	238,221	13,135	623	55	67	595	-	-	-	1,340	14,475	14,000
21	Total	464,716	$ 25,623	$ 1,215	$ 107	$ 130	$ 1,160	$ -	$ -	$ -	$ 2,612	$ 28,235	$ 28,000
22	Total Transmission System Sales	21,828,939	$2,653,298	$57,047	$ 5,019	$ 6,112	$ 54,480	$ 68,188	$ 83,621	$10,135	$284,602	$2,937,900	-
23	Sales from Production System												
24	Sales for Resale												
25	Natural Gas Pipeline Co. of America	20,783,301	$ 650,631	$54,314	$ 4,779	$11,722	$ -	-	-	-	$ 70,815	$ 721,446	$ 721,000
26	Amarillo Oil Co. (at well-head)	4,809,758	90,551	12,570	-	-	-	-	-	-	12,570	103,121	152,000 4/
27	Total	25,593,059	$ 741,182	$66,884	$ 4,779	$11,722	-	-	-	-	$ 83,385	$ 824,567	$ 873,000
28	Gas Used in Company Operations by Canadian Co.	477,624	$ 12,378	$ 1,248	$ 110	$ -	-	-	-	-	$ 1,358	$ 13,736	$ 14,000
29	Total Production System Sales	26,070,683	753,560	68,132	4,889	11,722	-	-	-	-	84,743	838,303	-
30	TOTAL SALES	47,899,622	$3,406,858	$125,179	$ 9,908	$17,834	$ 54,480	$ 68,188	$83,621	$10,135	$369,345	$3,776,203	$3,777,000

1/ MCF in Column 2 are volumes of gas at pressure of 14.65 pounds per square inch absolute.

2/ Adjustments in Columns 4 to 9 were assigned to each customer in accordance with procedure used in preparation of staff exhibit (Exh.226). Adjustments in Column 10 were assigned in proportion to distribution plant investment as of December 31, 1939, used to serve each customer.

3/ Figures for Arkansas Valley Natural Gas Company cover its service to Fountain Valley School only, because its remaining properties were sold to Citizens Utilities Company. Costs for the latter company include services communities formerly served by Arkansas Valley Natural Gas Company.

4/ Commission made one finding as to the combined total cost of serving Amarillo Oil Company from Denver Pipe Line and at well-head. Finding is shown on line 26, col. 13.

APPENDIX C

Tabulation showing number of hs natural gas deliveries to customers of Canadian and Colorado Companies were cmtely interrupted or partially reduced during the period from the beginning of sdse to each customer to December 31, 1940
(R Ex. 290; R. II, 1025-29)

Customers affected (1)	Complete interruption of all deliveries (Hours) (2)	Partial iuction in delivies for industripurposes: Due to physical causes (Hours) (3)	Due to high Demand (Hours) (4)	Total hours (2) (3) (4) (5)	Total period of service to December 31, 1940: Years (6)	Hours (7)	Percentage of time service was interrupted or reduced from all causes (8)	Percentage of total time, full and complete service was supplied (9)
Resale customers:								
Amarillo Oil Co.	43	0	0	43	12-1/2	109,500	0.04	99.96
Arkansas Valley Natural Gas Co.	12*	0	0	12	11	96,400	0.01	99.99
Citizens Utilities Co.	10*	0	0	10	11-3/4	102,900	0.01	99.99
Pueblo Gas and Fuel Co.	4-1/2*	15	0	19-1/2	12-1/2	109,500	0.02	99.98
City of Colorado Springs	9*	54	29	92	9-1/4	81,000	0.11	99.89
Public Service Company of Colorado	49	170	8	227	12-1/2	109,500	0.21	99.79
Colorado-Wyoming Gas Co.	38	109	30	177	11-1/4	98,600	0.18	99.82
Direct customers:								
American Crystal Sugar Co.	10*	0	0	10	11-1/4	98,600	0.01	99.99
Atchison, Topeka and Santa Fe R.R.	12*	30	5	47	11	96,400	0.05	99.95
Veteran's Administration Facility	13*	36	5	54	10	87,600	0.06	99.94
Colorado Fuel and Iron Corp.	4-1/2*	80	60	144-1/2	12-1/2	109,500	0.13	99.87
Colorado Portland Cement Co.	36*	93	24	153	9-3/4	85,400	0.18	99.82

Note: Percentages in column 8 are ratios of hours in column 5 to hurs in column 7.

* Entire interruption due to break in lateral line serving thi customer.

APPENDIX D

SUMMARY OF LEASE COSTS OF CANADIAN RIVER GAS COMPANY DECEMBER 31, 1939

Lease Costs, Per Books	
Bonuses	$2,097,486.81
Renewal costs	127,503.50
Delay rentals	109,100.84
Costs of obtaining leases (legal services, abstracting and recording fees and expenses)	67,163.88
Consideration paid for consolidation of leases	335,751.46
Total cost per books, excluding "appreciation" (R. V, 2737, 2741)	$2,737,006.49
Adjustments Made by the Commission:	
Add: Legal fees and expenses (R. V, 2723)	51,812.14
Deduct:	
Well construction costs erroneously included in lease account which were reclassified and allowed as well costs (R. V, 2667-71)	(343,656.76)
Intercompany profits on leases acquired from affiliates (R. V, 2657-61; 2667-71)	(250,320.54)
Lease Costs Included in Rate Base	$2,194,841.33*

* Includes $109,175.29 for unoperated leases (R. V, 2741). Interest during construction related to lease costs was included in a separate allowance (R. V, 2769) in the amount of $40,453.

DEPRECIATED LEASE AND PLANT COSTS ALLOWED IN RATE BASE

	Leases	Other Plant	Total
Undepreciated Plant Cost at December 31, 1939 (R. I, 149)	$2,194,841	$8,589,622	$10,784,463
Less:			
Accrued Depletion (leases & wells)	252,006	401,675	653,681
Accrued Depreciation		1,480,948	1,480,948
Total Depreciation and Depletion (R. I, 162)	252,006	1,882,623	2,134,629
Depreciated Plant Cost at December 31, 1939 (R. I, 164)	$1,942,835	$6,706,999	$8,649,834**

** Canadian's rate base was found to be $9,375,000 (R. I, 173) after adding working capital and plant additions through December 31, 1941.